



EXECUTIVE BUDGET OVERVIEW

INTRODUCTION

This chapter is an overview of the budget submitted for the 2007 Biennium by Governor Martz, pursuant to statute. This overview provides a summary of the more detailed agency budget presentation contained in Volumes 3 and 4 of the Legislative Budget Analysis, as well as statewide issues such as the pay plan. It is intended to provide the reader with a general understanding of the major components and priorities of the Martz budget. This and subsequent sections of this chapter include the following:

- Budget comparisons with the previous biennium
- Executive revenue proposals summary
- Executive expenditure proposals summary
- Statewide budget proposals and issues
- Other executive budget issues identified through Legislative Fiscal Division analysis

A number of relatively minor amendments to the original Martz budget were submitted by letter to the Legislative Fiscal Analyst on December 15, 2004. These amendments were not received in time to be included in this analysis. The amendments are summarized on page 114 and amendment items will be addressed individually during the legislative process at the prerogative of the legislature.

Governor-elect Schweitzer's changes to the budget must be submitted to the Legislative Fiscal Analyst and the legislature by January 7th. An analysis, if deemed necessary, of any submitted changes will be provided, in a separate document, to the legislature as soon as possible after the changes are received.

BUDGET COMPARISONS

The total 2007 biennium Martz budget request is \$2.5 billion general fund and \$6.9 billion total funds. The budget (HB 2) reflects a 9.9 percent general fund increase and a 10.6 percent increase in total funds as compared to the 2005 biennium. The overall net increase reflects the improved revenue picture and growing demands for services in almost all sectors of state government. The largest general fund dollar increases appear in Public Health and Human Services, Revenue, Public Education, Corrections, and Higher Education. The largest total fund increases occur in Transportation and Public Health and Human Services. Highlights of the executive budget proposal are presented on page 61.

The legislature and the public use comparisons to prior budgets as a benchmark for assessing budget growth and stability. There are two common methods utilized in the state budget process:

- Base year comparison – this method is used because the state budget is developed from a base year, but is not a good measure of true growth
- Biennial comparison – this is the method prescribed in statute for budget comparisons, and is a better measure because it takes into consideration the cyclical nature of the state budget

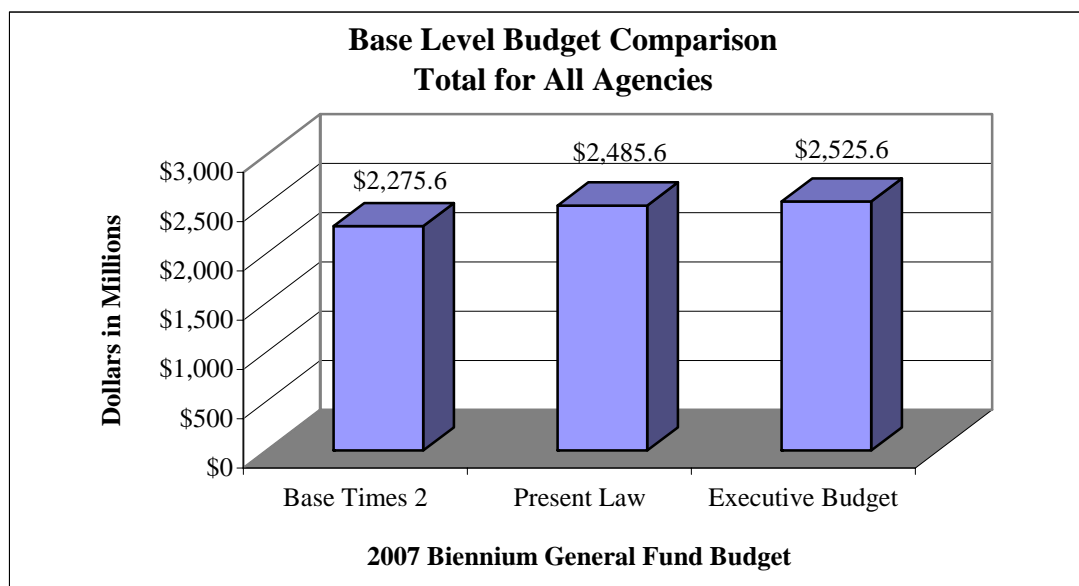
A discussion of each of these budget comparison methodologies follows. Please read the “Comparison Caution” on page 54 for a better understanding of the merits of these differing methodologies.

BASE LEVEL BUDGET COMPARISONS

In this volume and Volumes 3 and 4, the reader will see references to base budget, present law budget, and the executive budget. Important to consider is the relationship between these different looks at the budget. Base budget describes the actual costs for the base year (FY 2004). The present law budget, the amount of funding needed to maintain government services at the level authorized by the previous legislature, is developed for the upcoming biennium, which includes FY 2006 and FY 2007. The executive budget is the budget that is submitted to the legislature for the upcoming biennium, and by statute, must include the components of base and present law, plus the addition of any new proposals that the Governor wishes to pursue. These three levels of the budget are compared in Figure 1.

The base is represented as the base budget times two in order to compare on a biennium basis, and because the FY 2006 and FY 2007 budgets are developed from the base budget data. Figure 1 shows that the present law budget exceeds the base budget by \$210 million, reflecting adjustments to the base for such things as annualization of the 2005 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The total executive budget is \$40 million greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 and 4. The total executive budget is \$250 million greater than the base budget.

Figure 1



BIENNIAL BUDGET COMPARISON

This section summarizes executive recommendations for the 2007 biennium and compares it to expenditures and appropriations for the 2005 biennium.

The executive is recommending a 2007 biennium budget that includes an additional \$273 million general fund, an 11 percent increase over the 2005 biennium. Total requested increases (all funds) amount to \$692 million, a 10 percent increase. The executive proposal for general fund and total spending increases is supported by existing sources of revenue, with the large general fund and federal increases being indicative of substantial general fund and federal revenue increases estimated for the 2007 biennium. Transfers, including the one-time transfers of general fund proposed by the executive, are not included as required by the statutory methodology.

METHODOLOGY

The state budget is highly complex, and the methods used to compute comparisons within the context of that budget can vary considerably. Without consistent comparison methodology, the comparisons can also be subject to manipulation. The Legislative Finance Committee (LFC) developed a budget comparison methodology that measures budget performance using total state expenditures for state general operations funded by taxpayer taxes, licenses, and fees. This method helps ensure proper representation, fairness, balance, and consistency. Adopted by the 1997 legislature, use of the comparison procedures became a statutory requirement at that time. These procedures provide consistency of application and help avoid the potential for manipulation when comparing information.

COMPARISON TO 2005 BIENNIUM

Figures 2 and 3 compare expenditures/appropriations between the 2005 to 2007 biennia for general fund and total funds. As shown in the figures, the largest general fund changes are found in the Department of Public Health and Human Services, Department of Revenue, Office of Public Instruction, Department of Corrections, and the Commissioner of Higher Education. However, the largest increases in percentage terms occur in the departments of Administration, Revenue, Labor and Industry, and Environmental Quality. Only the Department of Agriculture shows a decline.

Figures 2 and 3 are divided into three sections:

1. The top part of the table includes all appropriations recommended for inclusion in HB 2 (the General Appropriations Act), by agency.
2. Because HB 2 does not include all appropriations authorized by the legislature, the second part of the table includes additional executive recommendations. This section is referred to as "Comparable Adjustments" because the items can be compared across biennia. The total shown in the "Total Exec. Budget Fiscal 06-07" (the 2007 biennium) column represents all recommendations made by the executive, with the exception of the non-cash portion of long-range building program, statutory appropriations, and transfers. Long-range building proposals are specifically excluded because spending and timing vary considerably on most building projects. The building expenditures are reflected by the debt service paid over the term of any bonding/leasing agreement. Statutory appropriations represent the executive estimates for non-general fund. General fund statutory appropriations are Legislative Fiscal Division estimates. (Note: The total in

the "Total Adjusted Fiscal 04-05" (the 2005 biennium) column does not represent all contingent appropriations in that biennium, which are included in the third section.)

3. The third section, "Non Comparable Adjustments", includes all 2005 biennium expenditure/appropriations, including budget amendments, supplemental appropriations, and disaster/emergency costs that cannot be estimated for the next biennium. Excluded from the "Comparable Adjustments" total are probable 2007 biennium expenditures that belong in this category. Consequently, the increases of 10.1 percent for general fund and 6.9 percent for total funds do not represent a true picture of potential growth between biennia.

House Bill 2 Comparisons

As shown in Figures 2 and 3, general fund recommendations in HB 2 increase \$227.9 million, or 9.9 percent, and all funds increase \$654.6 million, or 10.6 percent, with \$115 million of increases in state special revenue and \$312 million in federal special revenue. These are primarily due to additional state special expenditures in the Department of Transportation (\$52 million), Department of Public Health and Human Services (\$37 million), and additional federal funds expenditures in DPHHS (\$214 million), Department of Transportation (\$31 million), and K-12 Education (\$19 million).

Appropriation increases are summarized in the "Executive Expenditure Proposals Summary" section of this volume, page 61, and are detailed in the narratives of the specific agencies in Volumes 3 and 4.

Comparable Adjustments

Comparable adjustments include HB 2 plus all miscellaneous appropriation bills, including the employee pay plan bill and other appropriations bills, statutory appropriations, and other appropriation and expenditure adjustments. The executive recommends \$273 million in increased general fund expenditures for the 2007 biennium as compared to the 2005 biennium, an increase of 10.6 percent. The increase in total all funds spending over comparable 2005 biennium spending is \$692 million, or 10.1 percent.

Non-Comparable Adjustments

Non comparable adjustments, the third section, shows increases of 10.1 percent general fund and 6.9 percent total funds between biennia. As stated earlier, this comparison tends to be distorted by the lack of comparable information for the 2005 biennium. This section and these comparisons are shown for informational purposes only and to complete the listing of 2003 biennium expenditures.

COMPARISON CAUTION

Biennial Comparisons vs. Budget Base Comparisons

This volume compares the 2007 biennium Executive Budget to actual expenditures and expenditures/appropriations for the 2005 biennium. The methodology used is that prescribed by the budget comparison statute, and upholds the concept of a comparison of the total state budget from biennium to biennium. This is a particularly useful practice due to the cyclical nature of annual budgets. However, because the Executive Budget is prepared using a different statutorily defined process, there is a difference between the total changes indicated in this volume and those indicated in the individual agency and program budgets discussed in the Agency Budgets and Analysis section in Volumes 3 and 4.

Because present law adjustments are added to the base year (fiscal 2004) to determine a present law budget for the 2007 biennium and budget growth as prescribed by total adjustments, the intermediate year (fiscal 2005) is ignored. This method facilitates budget development from a vantage point of recent, actual experience, but overstates true budget growth because all increases are measured from the base year.

Conversely, using the base year (2004) plus fiscal 2005 appropriations for budget comparisons more accurately reflects true budget growth. This is because the increases/decreases are measured from a biennial perspective that takes into account the annual increase from the base year to the fiscal 2005 appropriated amount.

While consideration of increases over the base year is necessary to making budgetary decisions, the adjustments should not be used as measures of growth or for comparative purposes. When making comparisons, the total budget for the 2007 biennium should be examined in comparison with the total 2005 biennium, as described above.

Figure 2

General Fund Comparison
2005 Biennium Versus Executive Budget 2007 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 2007 Biennium - 2005 Biennium	% Change 2007 Biennium 2005 Biennium
1104	Legislative Branch	\$16,106,258	\$16,756,076	\$649,818	4.03%
2110	Judicial Branch	58,541,313	70,694,143	12,152,830	20.76%
3101	Governor's Office	8,818,012	9,603,495	785,483	8.91%
3202	Commissioner Of Political Practices	632,890	647,698	14,808	2.34%
3401	State Auditor's Office	0	0	0	NA
3501	Office Of Public Instruction	1,028,977,504	1,057,188,753	28,211,249	2.74%
4107	Crime Control Division	3,274,487	3,437,597	163,110	4.98%
4110	Department Of Justice	37,468,284	40,758,771	3,290,487	8.78%
5101	Board Of Public Education	305,290	332,640	27,350	8.96%
5102	Commissioner Of Higher Education	277,986,004	300,404,277	22,418,273	8.06%
5113	School For The Deaf & Blind	6,916,681	7,936,967	1,020,286	14.75%
5114	Montana Arts Council	576,604	647,261	70,657	12.25%
5115	Montana State Library	3,214,435	3,407,572	193,137	6.01%
5117	Montana Historical Society	3,481,698	3,812,033	330,335	9.49%
5301	Department Of Environmental Quality	6,217,300	8,226,437	2,009,137	32.32%
5603	Department Of Livestock	1,054,263	1,102,712	48,449	4.60%
5706	Dept Of Natural Resources & Conservation	34,320,252	42,916,695	8,596,443	25.05%
5801	Department Of Revenue	56,348,979	90,229,399	33,880,420	60.13%
6101	Department Of Administration	6,914,319	11,907,993	4,993,674	72.22%
6102	Appellate Defender	373,462	397,616	24,154	6.47%
6201	Department Of Agriculture	1,226,366	1,189,056	(37,310)	-3.04%
6401	Department Of Corrections	210,647,987	234,784,069	24,136,082	11.46%
6501	Department Of Commerce	3,149,336	3,250,436	101,100	3.21%
6602	Department Of Labor & Industry	2,353,932	3,674,419	1,320,487	56.10%
6701	Department Of Military Affairs	8,306,330	8,742,940	436,610	5.26%
6901	Dept Of Public Health & Human Services	<u>520,511,199</u>	<u>603,549,186</u>	<u>83,037,987</u>	<u>15.95%</u>
Total		\$2,297,723,185	\$2,525,598,241	\$227,875,056	9.92%
Comparable Adjustments					
	Employee Pay Proposal	In Above	31,544,045	31,544,045	
	Statutory Appropriations	255,227,183	268,691,065	13,463,882	5.28%
	Legislative Session Costs *	7,758,613	10,150,000	2,391,387	30.82%
	Miscellaneous Appropriations	31,716,939	12,225,000	(19,491,939)	-61.46%
	One-Time Only Costs	5,230,720		(5,230,720)	-100.00%
	Anticipated Reversions	(28,662,000)	(5,855,000)	22,807,000	-79.57%
	Total With Comparable Adjustments	\$2,568,994,640	\$2,842,353,351	\$273,358,711	10.64%
Non Comparable Adjustments					
	Budget Amendments	0		0	
	Supplementals	12,650,382		(12,650,382)	-100.00%
	Disaster/Emergency Costs (SA)	33,760	0	(33,760)	-100.00%
	Total With All Adjustments	\$2,581,678,782	\$2,842,353,351	\$260,674,569	10.10%
* Reversions of \$3,154,812 and \$3,150,000 are expected in the 2005 and 2007 biennia, respectively.					

Figure 3

All Funds Comparison
2005 Biennium Versus Executive Budget 2007 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 04-05	Total Exec. Budget Fiscal 06-07	Difference 2007 Biennium - 2005 Biennium	% Change 2007 Biennium 2005 Biennium
1104	Legislative Branch	\$20,164,335	\$20,969,368	\$805,033	3.99%
1112	Consumer Council	2,645,816	2,768,221	122,405	4.63%
2110	Judicial Branch	64,828,673	74,912,145	10,083,472	15.55%
3101	Governor's Office	21,383,896	20,009,849	(1,374,047)	-6.43%
3201	Secretary Of State's Office	0	11,026,465	11,026,465	NA
3202	Commissioner Of Political Practices	632,890	647,698	14,808	2.34%
3401	State Auditor's Office	9,429,943	10,212,169	782,226	8.30%
3501	Office Of Public Instruction	1,309,165,538	1,356,419,284	47,253,746	3.61%
4107	Crime Control Division	27,583,033	30,817,274	3,234,241	11.73%
4110	Department Of Justice	107,514,911	111,393,714	3,878,803	3.61%
4201	Public Service Regulation	5,943,474	5,715,138	(228,336)	-3.84%
5101	Board Of Public Education	649,375	717,625	68,250	10.51%
5102	Commissioner Of Higher Education	391,504,387	420,802,046	29,297,659	7.48%
5113	School For The Deaf & Blind	7,793,250	8,708,201	914,951	11.74%
5114	Montana Arts Council	2,093,201	2,186,409	93,208	4.45%
5115	Montana State Library	7,267,048	7,466,455	199,407	2.74%
5117	Montana Historical Society	7,731,532	8,414,189	682,657	8.83%
5201	Department Of Fish, Wildlife & Parks	107,793,794	116,409,329	8,615,535	7.99%
5301	Department Of Environmental Quality	114,755,361	139,836,831	25,081,470	21.86%
5401	Department Of Transportation	1,133,065,121	1,215,955,351	82,890,230	7.32%
5603	Department Of Livestock	16,748,481	16,201,608	(546,873)	-3.27%
5706	Dept Of Natural Resources & Conservation	72,081,283	86,640,136	14,558,853	20.20%
5801	Department Of Revenue	65,985,149	96,313,176	30,328,027	45.96%
6101	Department Of Administration	34,575,942	43,113,949	8,538,007	24.69%
6102	Appellate Defender	373,462	397,616	24,154	6.47%
6106	Mt Consensus Council	513,141	396,548	(116,593)	-22.72%
6201	Department Of Agriculture	22,354,505	27,341,542	4,987,037	22.31%
6401	Department Of Corrections	217,073,483	242,235,111	25,161,628	11.59%
6501	Department Of Commerce	38,107,439	44,953,910	6,846,471	17.97%
6602	Department Of Labor & Industry	127,113,412	132,484,291	5,370,879	4.23%
6701	Department Of Military Affairs	33,642,734	35,476,579	1,833,845	5.45%
6901	Dept Of Public Health & Human Services	<u>2,234,800,021</u>	<u>2,569,004,373</u>	<u>334,204,352</u>	<u>14.95%</u>
Total		\$6,205,314,630	\$6,859,946,600	\$654,631,970	10.55%
Comparable Adjustments					
	Employee Pay Proposal	In Above	63,084,241	63,084,241	
	Statutory Appropriations	634,370,097	608,233,561	(26,136,536)	-4.12%
	Legislative Session Costs	7,758,613	10,150,000	2,391,387	30.82%
	Miscellaneous Appropriations *	31,716,939	12,225,000	(19,491,939)	-61.46%
	One-Time Only Costs (general fund)	5,230,720	0	(5,230,720)	-100.00%
	Anticipated Reversions (general fund)	(28,662,000)	(5,855,000)	22,807,000	-79.57%
	Total With Comparable Adjustments	\$6,855,728,999	\$7,547,784,402	\$692,055,403	10.09%
Non Comparable Adjustments					
	Budget Amendments	193,584,323		(193,584,323)	-100.00%
	Supplementals	12,650,382		(12,650,382)	-100.00%
	Disaster/Emergency Costs (SA)	33,760	0	(33,760)	-100.00%
	Total With All Adjustments	\$7,061,997,464	\$7,547,784,402	\$485,786,938	6.88%

* Only the general fund portion is shown. All funds cannot be determined based on existing accounting records.



EXECUTIVE REVENUE PROPOSALS - SUMMARY

INTRODUCTION

The Executive Budget is based on estimated general fund revenues below those adopted by the Revenue and Transportation Committee on November 16, 2004. For a complete discussion of revenue estimates, see "General Fund Revenue Estimates" on page 41 of this report and Volume 2, Legislative Budget Analysis, Revenue Estimates.

This section presents a description of the revenue and tax policy proposals contained in the executive budget. Unlike previous budget proposals, the budget as submitted by Governor Martz does not include any tax policy proposals. There are two revenue initiatives that impact the revenue available to the general fund. These initiatives are discussed below.

REVENUE PROPOSALS

DEPARTMENT OF REVENUE COMPUTER SYSTEM LOAN

Senate Bill 271, adopted by the 58th Legislature, authorized the Department of Revenue (DOR) to secure up to a \$17.1 million loan from the Board of Investments. The loan was to be used to implement a new computer system to replace the existing Process Oriented Integrated Tax System (POINTS). Under the provisions of SB271, the loan was to be repaid through an assessment fee of up to 0.45 percent of selected general fund revenue sources. In FY 2004, the department assessed a fee against only the individual income tax for purposes of repayment.

The DOR is currently in the process of implementing the new system called the Integrated Revenue Information System (IRIS). In an effort to utilize available one-time general fund revenue, the executive budget proposes to use these one-time monies to pay off the loan to the Board of Investments. The loan balance is expected to be approximately \$16.0 million. As a result of the total loan repayment, the department assessment fee would be eliminated, which would increase individual income tax revenues to the general fund by \$6.0 million during the 2007 biennium.

DEPARTMENT OF JUSTICE PATHOLOGIST

The executive budget for the Department of Justices is requesting a pathologist associate medical examiner to address the increased number of autopsies conducted at the forensic lab. A forensic pathologist is responsible for determining the cause and manner of sudden unexpected deaths, or deaths unattended by a physician. The pathologist performs forensic autopsies, collects evidence to be analyzed by other scientists in the laboratory, serves as an advisor to the coroners throughout Montana, and reviews all coroners' reports on deaths occurring in the state. The forensic pathologist also assists investigators and scientists with crime scene reconstruction. Forensic pathology requires

specialized training and cannot be performed by hospital pathologists due to the nature of criminal cases.

The costs of these services would be billed to and paid by the counties in which the services were provided. The revenue collected would be deposited into the general fund to offset the cost of the additional pathologist position. The additional revenue is expected to be \$317,000 for the 2007 biennium.



EXECUTIVE EXPENDITURE PROPOSALS - SUMMARY

INTRODUCTION

This section discusses the major expenditures in the 2007 biennium proposed by Governor Martz. The purpose of this document is to provide the reader with a summary view of major trends and policies proposed. It is divided into two parts:

- A brief overview of general fund in total, including all appropriations made by both temporary and statutory appropriations, and all executive proposals that are contained in legislation separate from the general appropriations act (HB 2)
- A more detailed discussion of executive proposals in HB 2, which appropriates over 86.6 percent of all general fund expended by state government. This discussion does not include other major initiatives such as the state employee pay plan, statutory appropriations, and other non-HB 2 measures to balance the general fund budget. A detailed discussion of each agency's proposed budget is included in Volumes 3 and 4 of the Legislative Budget Analysis.

ALL GENERAL FUND – HIGHLIGHTS AND SUMMARY

COMPARISON TO THE 2004 BASE

FY 2004 is used as the starting point, or base, for all budget development, rather than the 2005 biennium. Therefore, spending proposals are presented as changes to that base.

Figure 1 shows the Governor's priorities from the doubled 2004 base. As shown, provision of services to recipients of various human services programs is over 25 percent of the total, followed by provision of a state employee pay plan and maintenance on state facilities. If funds to address rising populations in the state institutions are added, the total increases to over half of the proposed expenditure increase.

Figure 1

Major Factors - General Fund Increase
From the Doubled FY 2004 Base
2007 Executive Budget
(Millions)

Element	--- General Fund ---		
	Funds	Percent of Total	Cumulative Percent
Doubled 2004 Base	\$2,564.1	---	---
<u>Major Adjustments - \$354 million</u>			
Medicaid Matching Rate*	\$55.0	15.5%	15.5%
Human Services Caseloads and Service Changes	38.3	10.8%	26.4%
State Employee Pay Plan	31.6	8.9%	35.3%
Maintenance of State Buildings	30.0	8.5%	43.7%
Corrections Populations and Overtime	24.0	6.8%	50.5%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	6.5%	57.0%
MUS Enrollment/K-12 Enrollment/Inflation	19.4	5.5%	62.5%
Statutory Appropriations	15.5	4.4%	66.9%
Statewide Present Law Adjustments	15.4	4.4%	71.2%
Computer Systems Update/Completion/Replacement	13.5	3.8%	75.1%
MUS Shared Leadership/Equipment	9.9	2.8%	77.9%
Pension Funds Actuarial Soundness	7.2	2.0%	79.9%
DPHHS Institutional Costs (overtime, utilities, etc.)	6.6	1.9%	81.8%
License Plate Manufacture/Replacement**	4.5	1.3%	83.0%
Emergency Telecommunications	4.1	1.2%	84.2%
Protected Property Tax Reserve	4.0	1.1%	85.3%
Replace Cultural Trust Balance	3.9	1.1%	86.4%
All Other Agencies/Purposes (including feed bill and reversions)	<u>48.1</u>	13.6%	100.0%
Total 2007 Biennium	\$2,918.1	---	---

*Includes \$1.1 million for non-Medicaid expenditures that use the Medicaid matching rate.

**Includes expenditures in corrections and the Department of Justice

HB 2 PROPOSALS – HIGHLIGHTS AND SUMMARY

INTRODUCTION

The Governor proposes to spend \$2.5 billion general fund and \$6.9 billion total funds in HB 2 in the 2007 biennium. Figure 2 shows proposed general fund expenditures in the 2007 biennium by functional area of government.

K-12 education, human services, higher education, and corrections would consume 86.9 percent of the general fund budget in the 2007 biennium, compared to 88.7 percent in the 2005 biennium.

Figure 2

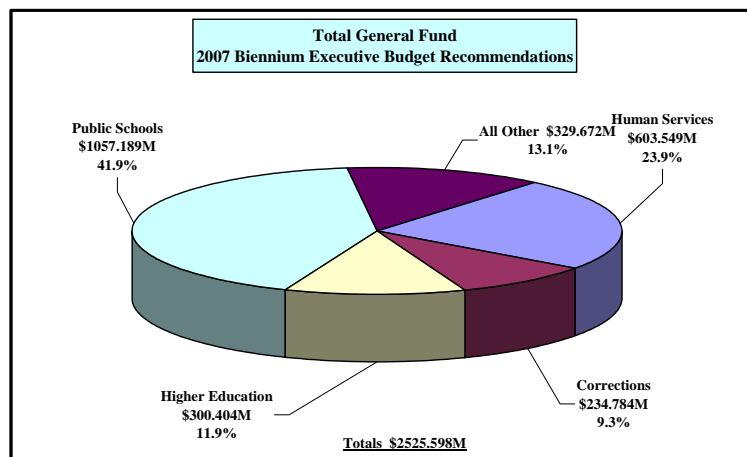
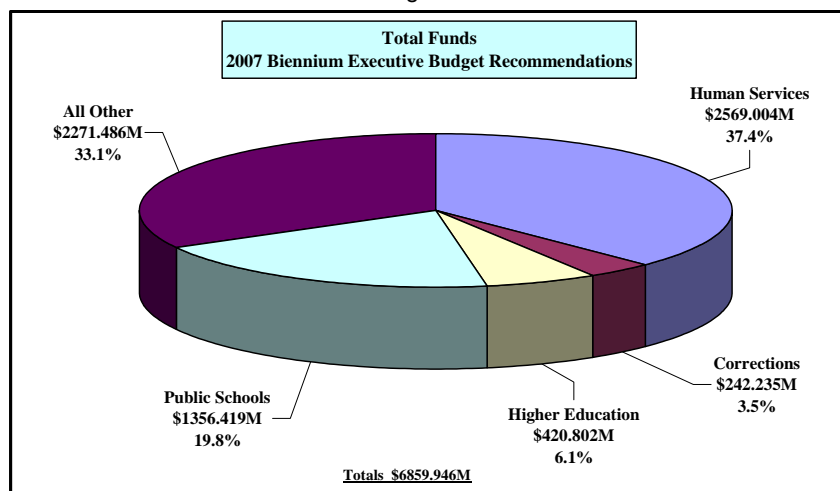


Figure 3



Because K-12 education, the HB 2 portion of higher education, and corrections are primarily funded with general fund, the picture changes significantly when looking at total funds. Human services, transportation, and environmental functions (including fish and wildlife management) all have an either significant state special revenue and/or federal funding presence. Figure 3 shows the total funds proposed by the Governor in the 2007 biennium. Human services and “all other government” (which includes

transportation and environmental functions) would be 70.5 percent of the total, compared to 69.1 percent in the 2005 biennium.

INCREASES OVER THE 2005 BIENNIUM

The 2007 biennium totals in HB 2 are an increase in general fund of \$227.9 million and in total funds of \$654.6 million over the 2005 biennium.

General Fund Increases

Figure 4

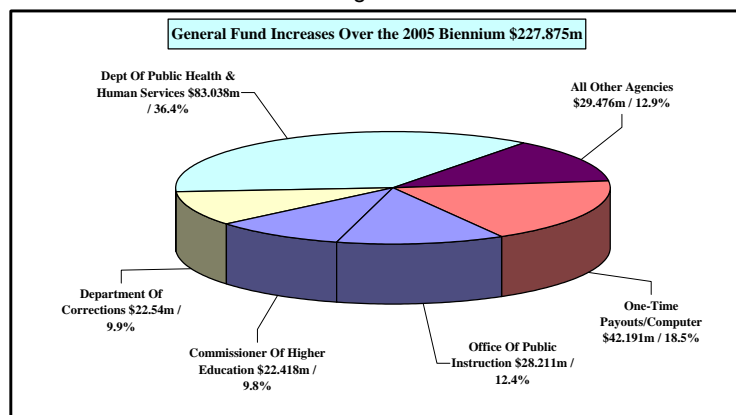


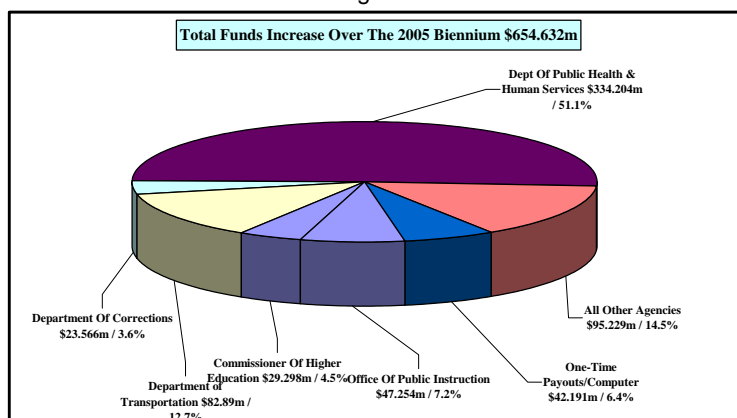
Figure 4 shows the Governor's allocation of the increases, by functional area of government. In that figure, the largest areas of increase in general fund are human services and all other government. The budget includes over \$42 million in one-time expenditures for payoff of debt and settlement agreements, and various one-time computer and other equipment purchases.

Figure 4 shows the allocation of the increase with these one-time expenditures separated.¹

Total Funds Increases

Figure 5 shows the allocation of increases in total funds, with the same one-time expenditures broken out. Please note that this figure also breaks out the Department of Transportation for illustrative purposes. That department is funded entirely with state special or federal revenue.

Figure 5



MARTZ ADMINISTRATION PRIORITIES

General Priorities

Several priorities are evidenced by the spending proposals of Governor Martz. The Governor:

- Funds all caseload increases in human services (even though the general fund portion of the cost of Medicaid goes up because of a reduction in the federal participation rate), and proposes a number of other service enhancements

¹ The Governor added over \$94 million in one-time expenditures (total excludes \$2 million in offsets for Crow Tribe settlement payments). However, \$8.9 million is included in the higher education total for one-time equipment purchases and shared leadership, \$4.4 million is included in the Department of Corrections to manufacture the new issue license plates, over \$1.0 million in several agencies for various purposes; and almost \$38 million is either appropriated in other bills or done via transfer.

- Funds all anticipated enrollment increases in K-12 and higher education, and funds a greater percentage of operating increases in higher education with general fund to reduce potential tuition increases
- Includes a statutory inflationary increase for K-12 Base Aid costs and increases in a number of other programs, including special education, school facilities, gifted and talented, and vocational education
- Adds private contract beds (private prisons and pre-release centers) to address correctional population growth, along with additional probation and parole officers
- Proposes a major economic development partnership with Montana University System, as well as major equipment purchases for two year education
- Funds all anticipated federal funds and state match for highways construction and maintenance, as well as continuance of Highway 93 construction
- Adds most anticipated federal funding increases, but would leave the bulk of any homeland security funding to be added during the interim
- Proposes to complete the total maximum daily load (TMDL) project and fully funds all positions in the Department of Environmental Quality
- Funds the personal services costs of all state employees, but then reduces the number funded with general fund by 60 FTE

The Governor does not include either of the following:

- Funding for any initiatives to address the recent court rulings on the school funding lawsuit
- Any homeland security funds that would go to the Department of Military Affairs for allocation to other entities

Governor's Priorities - Comparison to the Base

FY 2004 is used as the starting point, or base, for all budget development, rather than the 2005 biennium. Therefore, spending proposals are presented as changes to that base. The following discusses the Governor's priorities from the doubled 2004 base. The general fund increase from the base year is \$250 million compared to the \$228 million increase using a biennial comparison.

Increases by Activity

Figure 6 lists the major increases in the proposed budget by specific type of activity. The figure shows that over 37 percent of the total general fund increase (first two items) would be used to maintain and expand services to various recipients of human services. If the costs to operate the human services institutions are also added (6.6 percent), the total goes to 40 percent. Adding costs to address the growing correctional populations would bring the total to almost half of the general fund increase.

Figure 6			
Major Factors - General Fund HB 2 Increase From the Doubled FY 2004 Base 2007 Executive Budget			
Element	Funds	Percent of Total	Cumulative Percent
Doubled 2004 Base	\$2,275.6	---	---
<u>Major Adjustments - \$250.0 million</u>			
Medicaid Matching Rate*	\$55.0	22.0%	22.0%
Human Services Caseloads and Service Changes	38.3	15.3%	37.3%
Corrections Populations and Overtime	24.0	9.6%	46.9%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	9.2%	56.1%
MUS Enrollment/K-12 Enrollment/Inflation	19.4	7.8%	63.9%
Statewide Present Law Adjustments	15.4	6.2%	70.0%
Computer Systems Update/Completion/Replacement	13.5	5.4%	75.5%
MUS Shared Leadership/Equipment	9.9	4.0%	79.4%
DPHHS Institutional Costs (overtime, utilities, etc.)	6.6	2.6%	82.1%
License Plate Manufacture/Replacement**	4.5	1.8%	83.9%
Emergency Telecommunications	4.1	1.6%	85.5%
All Other Agencies	36.2	14.5%	100.0%
Total 2007 Biennium	\$2,525.6	---	---

Increases by Functional Area of Government

The proposed general fund increases can also be examined by general functional area, which shows that human services in total would receive over 40 percent of the total general fund increase, and the addition of K-12 education, corrections, and higher education would total over 72 percent of total general fund increases. When one-time expenditures for debt and/or settlement costs, computer enhancement, and telecommunications infrastructure are added, they comprise almost 90 percent of the Martz administration proposed general fund increases, as shown in Figure 7.

As a result of these priorities, the amount of general fund going to human services would increase from 22.6 percent of the total in the 2005 biennium to 23.9 percent in the 2007 biennium.

Governor's Priorities – Summary

The following provides a reference to the major changes proposed by the Governor, and their impact on source and allocation of funding.

Figure 7 Major Factors - General Fund HB 2 Increase From the Doubled FY 2004 Base 2007 Executive Budget			
Element	Funds	--- General Fund --- Percent of Total	Cumulative Percent
Doubled 2004 Base	\$2,275.6	---	---
Major Adjustments - \$250.0 million			
Human Services	\$106.7	42.7%	42.7%
K-12 Education	29.0	11.6%	54.3%
Corrections	26.7	10.7%	65.0%
Higher Education	18.8	7.5%	72.5%
Payment of all IRIS Computer System Debt/Crow Tribe Settlement	23.0	9.2%	81.7%
Computer Systems Update/Completion/Replacement	13.5	5.4%	87.1%
Emergency Telecommunications	4.1	1.6%	88.7%
All Other Agencies	<u>28.1</u>	11.2%	100.0%
Total	\$2,525.6	---	---

FTE	
FTE would increase by over 106 in FY 2006, with a drop of about 15 FTE in FY 2007, for a total increase over the biennium of 91.16. Major increases are in the Departments of Transportation; Fish, Wildlife, and Parks, and Environmental Quality. Increases are partially offset by a reduction in 60 FTE funded with general fund to make permanent personal services reductions enacted by the 2003 Legislature	
General Fund/Total Funds	
General Fund	General fund increases by \$227.9 million, or 9.9 percent, to \$2.5 billion
Total Funds	Total funds increase by \$654.6 million, or 10.6 percent, to \$6.9 billion
Major Present Law Adjustments	
Human Services	<ul style="list-style-type: none"> Maintenance of Medicaid recipient eligibility through additional total funding, and increased general fund required by reduction in the federal participation rate
K-12 Education	<ul style="list-style-type: none"> Inflationary increases and adjustments for enrollment changes Maintenance of FY 2005 expenditures for special education Utilization of all anticipated federal funding increases
Higher Ed	<ul style="list-style-type: none"> Adjustments for anticipated enrollment increases Increase in percent of general operating expense increases funded with general fund to reduce tuition increases
Corrections	<ul style="list-style-type: none"> Increases in private contract beds, private pre-release beds, and probation and parole officers to address rising populations New issue license plate manufacturing costs
All Other Gov't	<ul style="list-style-type: none"> Operate IRIS (Integrated Revenue Information System) Complete total maximum daily load (TMDL) in environmental programs, and match anticipated federal funds for highways construction, and other purposes
All Agencies	<ul style="list-style-type: none"> Statewide present law adjustment for personal services, fixed costs, and inflation
Major New Initiatives	
Human Services	<ul style="list-style-type: none"> Medicaid redesign initiatives to utilize existing state resources to expand coverage Continued utilization of tobacco control and prevention funds for other programs Increased enrollment in CHIP Continuation of hospital provider tax, bed tax, and intergovernmental transfers to match additional federal funds
K-12 Education	<ul style="list-style-type: none"> Increased special education, gifted and talented, school facility payments, and vocational education payments to schools Planning and coordination of Indian Education for All
Higher Ed	<ul style="list-style-type: none"> Economic development partnership funds and equipment purchases
Corrections	<ul style="list-style-type: none"> Replacement of the offender tracking system
All Other Gov't	<ul style="list-style-type: none"> Payoff of certain debts and settlements* Completion of computer systems Emergency telecommunications Judiciary payment of "unfit to proceed" costs
Fund Source	
The budget once again continues a trend in recent biennia of a growing federal share of the total state budget (page 71). However, the increase in federal fund share is significantly smaller than in previous biennia due to the almost 10 percent increase in general fund, and in part due to a reduction in the percentage of Medicaid benefits costs paid by the federal government.	
Functional Share of the Budget	
K-12 education's share of the general fund budget continues to fall due primarily to continued falling enrollments, and large increases in human services and one-time expenditures. Human services would increase to 23.9 percent of the total.	

EXECUTIVE NEW INITIATIVES (NEW PROPOSALS)

The Governor proposes just over \$40 million in general fund new initiatives in HB 2, and an additional \$72 million outside of HB 2. The Governor's new initiatives are presented in more detail on page 96.

Figure 9 Major New Initiatives - Executive Budget 2007 Biennium (Millions)	
Agency/Initiative	Amount
<u>Revenue Proposals</u>	
Department of Revenue Loan Payback*	(6.0)
Department of Justice Pathologist	(0.3)
Total Revenue Proposals (revenue increase)	(6.3)
<u>Expenditure Proposals</u>	
Increased repair/maintenance (long-range building)	\$30.0
State employee pay plan	31.6
Protested property tax reserve	4.0
Replace cultural trust fund balance	3.9
Pay federal government for share of workers' compensation transfer to general fund	0.2
Pension funds actuarial soundness	7.2
Other Language Appropriations	1.4
Total Non-HB 2 Expenditure New Proposals	\$78.3
<u>HB 2</u>	
Various - Enhance/Complete Computer Systems**	\$9.9
OPI - Various Education Programs	5.5
University System - 2 Year Education Units Equipment	5.0
University System - Shared Leadership	4.9
Administration - Emergency Telecommunications	4.1
DPHHS - Add Waiver Clients/Reduce Wait List/Meals on Wheels/Psych Access	2.2
Judiciary - "Unfit to Proceed" Costs	2.0
DPHHS - Nursing Home Bed Tax	1.9
DPHHS - CHIP Enrollment Increase	1.7
Labor and Industry - Employment Security Account Funding Switches***	1.2
DPHHS - Child Support Maintenance	0.8
DPHHS - Continuance of Diversion of Tobacco Tax	0.7
Administration - Public Safety Communications	0.6
OPI - Indian Education for All	0.5
Other Agencies, Net of Miscellaneous Reductions****	-1.0
Total HB 2 New Proposals	\$40.0
Total Expenditure New Proposals	\$118.3
Total New Proposals	\$112.0
*Savings as a result of \$16 million IRIS debt payoff	
**Includes only those enhancement requested in new proposals. As such, it excludes completion of POINTS, and the gambling control enhancement.	
***Reversal of fund switch enacted by the 2003 Legislature	
****Various costs savings in DPHHS total \$3.1 million. The Department of Justice statewide FTE reduction (\$0.46 million) is included in new proposals.	

EXECUTIVE PROPOSALS BY PROGRAM AREA

Figure 10 summarizes expenditures of state government as proposed by the Governor and compares these totals to the 2005 biennium, by function of government. For a graphic display (pie charts) of the data in Figure 10, see Figure 2 (General Fund Budget), Figure 3 (Total Funds Budget), Figure 4 (General Fund Increases), and Figure 5 (Total Fund Increases).

Each of the program areas, along with the Department of Transportation, is discussed in the narrative that follows. Further discussion is included in the individual agency narratives in Volumes 3 and 4.

Figure 10 Proposed Executive Budget by Program Area - HB 2 2005 to 2007 Biennia				
--- General Fund ---				
Component	Executive Budget	Increase Over 2005	Percent Increase	Percent of Increase
K-12 Education	\$1,057,188,753	\$28,211,249	2.7%	12.4%
Higher Education	300,404,277	22,418,273	8.1%	9.8%
Corrections	234,784,069	24,136,082	11.5%	10.6%
Human Services	603,549,186	83,037,987	16.0%	36.4%
All Other Government Agencies	329,671,956	70,071,465	27.0%	30.7%
Total	\$2,525,598,241	\$227,875,056	9.9%	
--- Total Funds ---				
Component	Executive Budget	Increase Over 2005	Percent Increase	Percent of Increase
K-12 Education	\$1,356,419,284	\$47,253,746	3.6%	7.2%
Higher Education	420,802,046	29,297,659	7.5%	4.5%
Corrections	242,235,111	25,161,628	11.6%	3.8%
Human Services	2,569,004,373	334,204,352	15.0%	51.1%
All Other Government Agencies	2,271,485,786	218,714,585	10.7%	33.4%
Total	<u>\$6,859,946,600</u>	<u>\$654,631,970</u>	10.5%	

K-12 Education

The budget for OPI in the 2007 biennium exceeds the 2005 biennium by \$47.1 million. \$46.9 million is in the distribution to schools program. Of this amount, \$19.8 million is due to increases in federal funds, and \$27.1 million is increases in the general fund.

In the 2005 biennium, 297,120 students will be served, and it is expected that in the 2007 biennium 289,225 students will be served, a reduction of 7,895 students. At constant entitlements, the state would have saved \$25.0 million in Base Aid between biennia as a result of declines in student numbers. However as a result of an increase in Base Aid entitlements in FY05 (2.07 percent) and budgeted inflationary increases in FY2006 (2.1 percent) and FY2007 (2.19 percent), the general fund biennial difference due to entitlement increases is \$48.3 million, for a net biennial increase in general fund Base Aid of \$23.3 million. In addition, state special education grants in the general fund increase by \$3.8 million between the biennia.

For a further discussion, see the Office of Public Instruction narrative beginning on page E-1 of Volume 4.

Higher Education

The 2007 biennium executive budget for the Montana University System proposes increases (through both present law adjustments and new proposals) that total \$22.4 million general fund (\$29.3 million total funds) above the 2005 biennium budget.

These increases are driven primarily by the following two changes in the university system budget:

- Shared Leadership Project initiatives, which seek to position the university system as an engine of economic development in Montana, total \$9.9 million general fund for new proposals

- Changes in the funding formula that determines the state share of operational costs in the university units result in state funding at approximately an 80 percent level as opposed to the historical formula of 43 percent - The total state share of increased university operating costs in the 2007 biennium is \$11.5 million general fund--\$5.3 million of that increase can be attributed to the executive 80 percent funding level

Enrollment projections in the executive budget, on the other hand, include modest increases at the university educational units, averaging 0.59 percent per year in the 2007 biennium.

In the area of tuition, the executive budget proposes that university educational unit tuition should only need to increase at a 2 percent per year rate during the 2007 biennium, including the executive proposal for HB 13 (state employee pay plan). However, the Office of the Commissioner of Higher Education projects that the executive budget, together with the HB 13 (pay plan) proposal, would lead to tuition increases of 4.3 percent in FY 2006 and 4.4 percent in FY 2007.

For a further discussion, see the narrative for the Office of the Commissioner of Higher Education beginning on page E-75 in Volume 4.

Corrections

The Governor proposes increases in the 2007 biennium of \$24.1 million general fund (\$25.2 million total funds), or 11.5 percent over the 2005 biennium. The Governor has addressed the projected increase in adult male offenders by proposing the expansion of private, contract prison and pre-release beds as well as an increase in the number of probation and parole officers.

The Governor proposes the following increases:

- \$13.2 million for additional offender beds in non-state owned facilities (contract facilities)
- \$4.4 million to produce new license plates to support the January 1, 2006 mandated replacement
- \$2.7 million for additional pre-release beds
- \$1.6 million for a new automated offender tracking system
- \$1.4 million for additional staff in probation and parole

The average daily population, which grew by 4.46 percent during FY 2004, is expected to grow by 4.40 percent during FY 2005 and by 4.44 percent and 4.50 percent during FY 2006 and FY 2007, respectively. This increase is 1,443 additional offenders between FY 2004 and FY 2007. The average daily population in secure facilities is expected to grow from 2,646 in FY 2004 to 3,194 in FY 2007, which is an increase of 548 offenders, or 20.7 percent.

For a further discussion, see the narrative for the Department of Corrections beginning on page D-64 of Volume 4.

Human Services

The DPHHS 2007 biennium budget request is \$334 million total funds higher than the 2005 biennium budget of \$2.2 billion. General fund increases from \$520 million to \$603 million, or 16 percent. The increase is dominated by maintenance of services to Medicaid recipients and other service recipients due to caseload growth. The Governor also proposes a number of initiatives, including Medicaid

redesign, which would utilize existing state funds to expand services with federal funds. Budget increases are due to:

- Medicaid eligibility, service utilization changes, and rate changes - \$190 million total funds (\$32 million general fund)
- Food stamp increases - \$45 million federal funds
- Health Insurance Flexibility and Accountability (HIFA) Waiver, which is part of Medicaid redesign - \$20 million federal funds
- Increases in cash assistance, work support grants, and other initiatives - \$16 million in federal TANF (Temporary Assistance for Needy Families) block grant funds
- Child care benefits - \$14 million in TANF block grant funds
- Federal categorical grants for public health, emergency preparedness, and federal commodity distribution - \$13 million federal funds
- Continued diversion of a portion of the tobacco settlement proceeds from tobacco control and prevention to other uses - \$11.9 million state special revenue
- Foster care and subsidized adoption caseload growth - \$6.9 million total funds (\$3.5 million general fund)
- State institution costs for overtime, and inflation in medical, food, and utility costs - \$5 million general fund

Medicaid services are a significant component of the DPHHS budget, totaling \$1.3 billion in expenditures for the 2007 biennium, or almost 60 percent of the total DPHHS request. Medicaid services are funded by state funds (about 30 percent) and federal funds (about 70 percent). The 2007 biennium DPHHS budget request grows \$55 million in general fund and declines by a like amount of federal funds due to federal Medicaid match rate changes.

For a further discussion, see the narrative for the Department of Public Health and Human Services beginning on page B-1 of Volume 3.

Transportation

The Department of Transportation 2007 biennium budget request has an additional \$82.9 million over the 2005 biennium. The proposals that contribute significantly to this increase are:

- Increases for payments to highway construction contractors and for other related construction activities for the federal-aid construction program
- Re-appropriation of 2005 biennium funding for construction of the project on US Highway 93 between Evaro Hill and Polson, due to project delays in FY 2004
- Re-appropriation of 2005 biennium funding for a runway rehabilitation project at the Lincoln airport, due to project delays in FY 2004
- Transfer of the Motor Carrier Assistance Program to the department from the Department of Justice

For a further discussion, see the narrative for the Department of Transportation beginning on page A-97 of Volume 3.

All Other Agencies

Major changes in other agencies comprise a large share of the increase in both general fund and total funds. Major general fund changes include:

- Payoff of all debt for the Department of Revenue's revenue system (IRIS) - \$16.0 million

- Payoff of the Crow Tribe settlement - \$7.0 million
- Increased costs of district courts, including additional costs to pay “unfit to proceed” costs at Montana State Hospital - \$12.2 million
- Initial costs of an emergency telecommunications network - \$4.1 million
- Total funds increase for the reasons above, and the following:
 - Addition of federal funds for the Help America Vote Act - \$11 million
 - Additional federal grants and expenditures from the general license account for a variety of purposes in the Department of Fish, Wildlife, and Parks - \$8.6 million
 - Major Facility Siting Act (MFSA), CERLA, MEPA, orphan share, and mine waste bonding and/or project authority in the Department of Environmental Quality, along with miscellaneous other expenses and completion of the total maximum daily load project - \$25.1 million

EXECUTIVE PROPOSALS BY FUND SOURCE

Figure 11 shows the allocation by funding source of state government in HB 2 in the 2007 biennium. This pie chart graphically displays the heavy reliance of this state on the use of federal funds for state services, as federal funds have grown to nearly half of the total budget.

As shown in Figure 12, general fund would increase by \$227.9 million, or 9.9 percent. State special would increase by \$115.9 million, or 11.6 percent. Federal funds would increase by \$311.8 million, or 10.8 percent. Reasons for the increases are discussed below, by fund type.

Figure 11

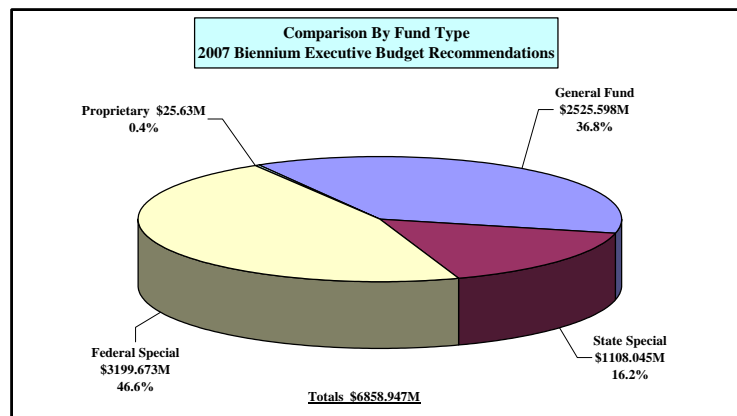
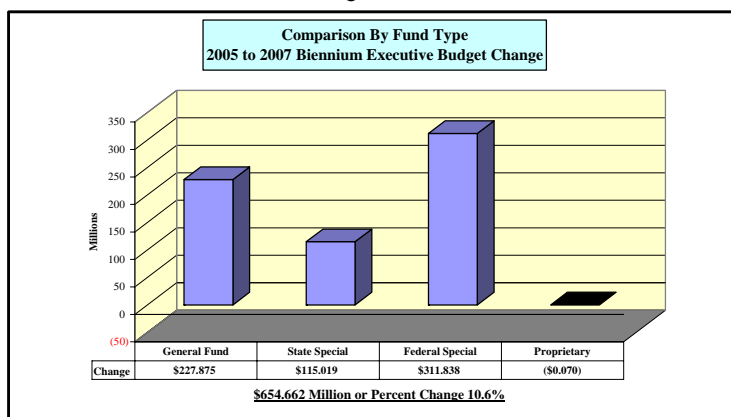


Figure 12



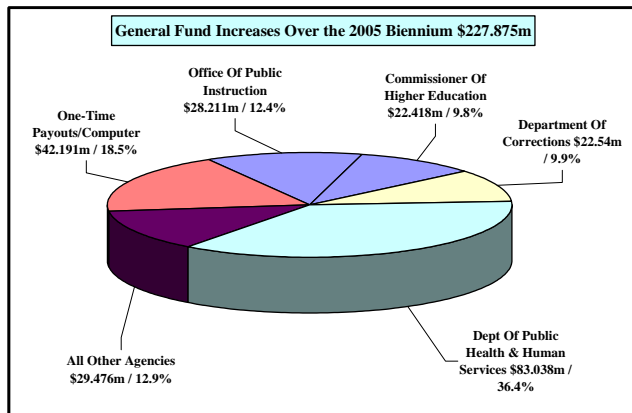
General Fund

General fund would increase by \$227.9 million, or 9.9 percent.

General fund continues to be a smaller percentage of the total state budget. However, the reduction in share is significantly smaller than in recent biennia because the Governor is proposing a percent increase in general fund only slightly less than the proposed percent increase in federal funds.

The Governor's proposed increase is dominated by five factors, which account for 84 percent of the increase, as shown in Figure 13 and discussed below.

Figure 13



- Human services increases \$83 million, or 16 percent. This increase is 36 percent of the total. The Governor:
 - Maintains services for recipients of various programs, most notably Medicaid, despite a reduction in the share of Medicaid (and other programs that are linked to the Medicaid match rate) that the federal government will pay
 - Adds funds for various expenses at the state institutions

- One-time payouts and computer development/enhancement account for over \$42 million, or almost 19 percent of the total.

The Governor recommends paying all remaining Crow Tribe and IRIS (DOR computer system) debt service obligations, totaling \$23.0 million. Computer development/enhancements add another \$19.1 million.

- K-12 Education would increase by \$28.2 million, or 2.7 percent. This increase, while minor against the \$1.1 billion biennial budget, is over 12 percent of the total increase. The Governor does not add any initiatives to address the recent school funding lawsuit rulings. Increases are inflationary adjustments to the Base Aid appropriation, and various other adjustments for programs such as special education, gifted and talented, school facilities, and vocational education.
- Corrections is \$24.1 million, or almost 10 percent of the increase. The Governor proposes to address rising populations by:
 - Adding private, contract beds in secure care and pre-release
 - Adding state FTE probation and parole officers
- Higher Education would increase by \$22.4 million, or 8 percent. The Governor has two priorities:
 - All enrollment increases and other operating costs are funded, and the share of general fund of these increases is increased to help reduce potential tuition increases
 - Almost \$10 million is added for Shared Leadership, which attempts to position the Montana University System as a driver of economic development, and for equipment purchases at the vocational technical schools

State Special Revenue

State special revenues would increase by \$115 million, or 11.6 percent.

- While most agencies receive funding from one or more state special revenue accounts, three areas of government account for over 85 percent of the increase.
- Department of Transportation increases by \$52.4 million, or 10.6 percent. Federal highway funds increase, and the Governor recommends matching the anticipated federal funds to ensure the most favorable matching rate.

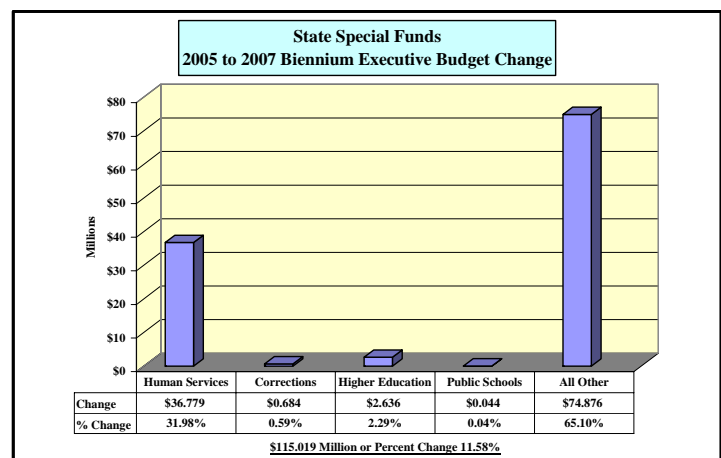


Figure 14

The Governor also adds funding for the Highway 93 project, which will be reimbursed by the federal government.

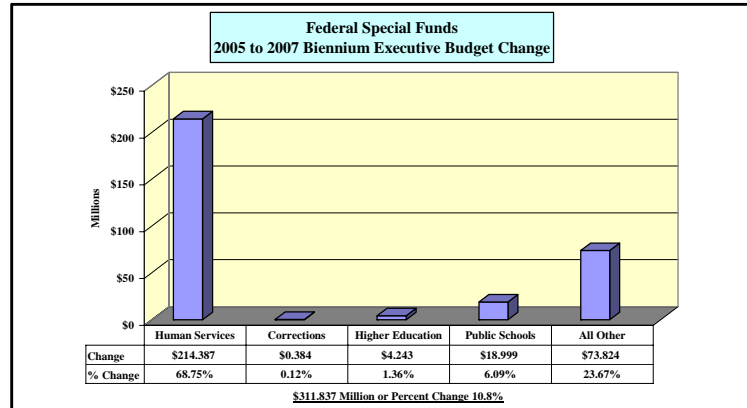
- Human services increases by \$36.8 million, or almost 43 percent. The Governor proposes to continue to divert tobacco settlement funds from tobacco prevention and control to other programs in the Department of Public Health and Human Services, and would continue the hospital provider tax and intergovernmental transfers used to match federal funds
- The Department of Fish, Wildlife, and Parks would be increased by \$8.8 million, or 13.4 percent. This increase is due to increases in state match for federal funds, as well as other initiatives

Federal Funds

Federal funds increase by 10.8 percent, or \$311.8 million.

- While both federal funds and increases are widely dispersed across state government, human services accounts for almost 70 percent of the total increase, while the Department of Transportation accounts for an additional 10 percent. One significant federal funding source not included in the 2007 biennium budget is homeland security grants to the Department of Military Affairs. Because of the uncertainty of the size and timing of Montana's grant, the Governor would leave this appropriation to the budget amendment process in the interim. For a further discussion of the issues of this exclusion, see the Department of Military Affairs on page D-172 in Volume 4.
- Significant changes in human services are due to:
 - Rising caseloads and service utilization, most notably in Medicaid and food stamps
 - Continued use of hospital provider tax, bed tax, and intergovernmental transfers to secure additional federal funds
 - Medicaid redesign, which uses proposed waivers to utilize current state funding to match additional federal funds
 - Anticipated increases in categorical grants
- The failure of Congress to pass a highway funding bill has made the level of federal funds the state will receive in the 2007 biennium uncertain. The budget assumes an increase from the 2005 biennium of \$30.5 million, based upon the average of the current House and Senate versions.
- The federal presence in K-12 education continues to grow. While still only a fraction of total expenditures in this area, federal funds increase by \$19 million, or 7 percent.

Figure 15





STATEWIDE EXECUTIVE BUDGET PROPOSALS/ISSUES

INTRODUCTION/HIGHLIGHTS

INTRODUCTION

This section discusses several stand-alone features of the executive budget that either do not pertain to any one agency, or which impact several agencies. These items are listed below and discussed in more detail in the following pages.

HIGHLIGHTS

- **Supplemental Appropriations – Fiscal 2005.** The executive's preliminary supplemental recommendation totals \$12.65 million general fund, with requests for district court expenditures, corrections, child support, and foster care dominating the total.
- **Executive Pay Plan Proposal.** The executive includes funding for a 3 percent per year salary increase beginning October 1 each year, and an increase in insurance contributions each year of \$46 per month for FY 2006 and \$51 per month for FY 2007. The Governor has included \$30 million general fund and \$28.5 million other funds for these increases.
- **FTE.** Total FTE would increase by 106.09 in FY 2006 and 91.16 in FY 2007 over the FY 2004 level. However, these increases are net of a number of increases and decreases, including statewide FTE reductions proposed by the Governor, targeting FTE funded with general fund.
- **Vacancy Savings.** The executive has applied a 4 percent vacancy savings rate to all personal services, including insurance contributions.
- **Pension Funds.** Pension funds in most states, Montana included, are experiencing significant unfunded liabilities due to investment losses. The state as employer is liable for the solvency of the funds. The executive budget includes over \$7 million general fund to address this issue.
- **Fee Changes.** The executive budget proposal includes changes in fees in two agencies, with the effect of increasing expenditures from other funds. The increase in other funds is \$3.7 million.
- **Fund Switches.** The executive has included a number of funding switches in the executive budget. Due to unique circumstances, the funding switches increase general fund expenditures by over \$7.0 million in the 2007 biennium.
- **One-Time Only Expenditure Proposals.** The executive proposes over \$94 million in one-time expenditures.
- **Executive New Initiatives (New Proposals).** The Governor proposes over \$118 million in general fund new initiatives (new proposals) in the 2007 biennium.
- **Fixed Costs.** Fixed costs increase by over \$7.7 million in the 2007 biennium over the 2005 biennium appropriations.

- **Inflation/Deflation.** Inflation or deflation was applied to 10 expenditure items for the 2007 biennium. Three were inflationary and 7 were deflationary. Natural gas experienced the largest increase.
- **Long-Range Planning Proposals.** The Governor's request for Long-Range Planning includes a total of \$197.2 million for capital projects, grants, and loans. Projects in the Long-Range Building Program make up the largest portion, with \$161.2 million. Only one other biennium (1997) in the last 10 biennia exceeded this amount. The portion of LRBP projects funded outright (not by GO bonds) is \$156.1 million, which is the most spent in this category. There is only one bonded project.

SUPPLEMENTAL APPROPRIATIONS

Supplemental appropriations are used to increase existing spending authority for a fiscal year. The supplemental appropriations requested by the executive are for additional funding applicable to the current year, fiscal 2005. The original budget for fiscal 2005 was approved by the 2003 legislature.

Figure 1 shows supplemental appropriations since the 1987 biennium.

Figure 2 provides detail on the executive's \$12.7 million in requested general fund supplemental appropriations. As shown, funds are being requested for a number of agencies.

REQUESTED SUPPLEMENTAL APPROPRIATIONS

The following briefly discusses each request. The individual supplemental requests are discussed in more detail in the individual agency narratives in the *Agency Budget Analysis* section of the *Legislative Budget Analysis*, Volumes 3 and 4.

Judiciary

The Judiciary has two requests for supplemental appropriations.

1. **District Courts** - The Judiciary assumed responsibility for the oversight and administration of the 22 judicial districts in FY 2003. Expenses that had been funded by the counties prior to assumption are now funded from the general fund.

Department/Program	General Fund	Other Funds
Judiciary		
District Court Costs	\$5,800,000	
Unfit to Proceed" Costs	1,000,000	
Corrections		
Increased Populations/Overtime	3,000,000	
Governor's Office		
Elected Official Payout	253,000	
Commissioner of Political Practices		
Elected Official Payout	9,620	
Justice		
Employee Payout	24,000	
Major Litigation	200,000	36,000
Highway Patrol Retirement Fund	363,762	
Public Health and Human Services		
Child Support Enforcement	857,058	
Foster Care	1,142,942	
Total	<u>\$12,650,382</u>	<u>\$36,000</u>

Figure 1
General Fund Supplementals
1987 to 2005 Biennia

Biennium	Millions
1987	\$32.7
1989	17.1
1991	20.4
1993	82.2
1995	19.9
1997	14.2
1999	11.5
2001	68.2
2003	12.5
2005	12.7

Expenditures significantly exceeded the appropriation throughout the biennium due largely to higher variable costs (those costs associated with caseload), particularly in indigent defense. These higher costs are expected to be ongoing, as the increase in variable costs was not due to any unique, or uniquely costly, cases.

2. **Unfit to Proceed** - Statute states that the district courts are responsible for the expense of commitment of defendants to Montana State Hospital under a district court order to determine the fitness of an individual to proceed in a criminal case against that individual. Montana State Hospital assumed these costs in prior years, but will now bill the Judiciary. The executive adds \$1.0 million for these costs. There is no net impact however, as a like amount will be deposited to the general fund.

Corrections

The Department of Corrections has experienced higher overtime costs and population growth (primarily in secure facilities) than anticipated by the 2003 legislature. The department received a portion of the personal services contingency fund appropriated by the legislature, and also used a portion of a biennial appropriation as an “advance” to avoid a supplemental appropriation in FY 2004.

Governor’s Office/Commissioner of Political Practices

Supplemental requests have been submitted for termination pay for exempt employees in the office of the Commissioner of Political Practices and the Governor’s Office. When an employee leaves state government, they are entitled to a payout of all annual leave up to a maximum level, and a portion of all sick leave balances. The term of the current commissioner of political practices expires in FY 2005 and payout is requested for all eligible balances. In addition, the Governor has a number of exempt staff (those who serve at the pleasure of the Governor) who will likely leave state service. The amount in the Governor’s budget assumes payout of all eligible balances to all exempt employees. If certain exempt employees do not leave state service, this number will be refined. Please note that staff of the Secretary of State is paid from a non-appropriated proprietary fund, and no appropriation is required for any potential payouts. Other statewide elected officials were re-elected, and no significant staff turnover is expected.

Department of Justice

There are three requests for the Department of Justice:

1. Employee payout – This appropriation would fund the severance costs of a retiring long-time employee.
2. Legal services major litigation – The legislature provides a \$400,000 biennial general fund appropriation for the costs of major litigation. By their nature, these costs are unknown at the time of appropriation. Additional costs are associated with long-standing cases such as tobacco settlement maintenance, and other cases such as snowmobile, school distribution, and other issues.
3. Highway patrol retirement fund – Legislation passed by the 2003 legislature directed a one-time fee of \$1.25 per vehicle for the Montana Highway Patrol pension trust fund. However, sufficient authority was not provided to make the necessary transfer from the general fund to the account. This request would have no impact on the general fund, as the total amount was already assumed in the level of transfers anticipated from the general fund.

Department of Public Health and Human Services

The executive seeks supplemental appropriations for two programs.

1. Child Support Enforcement Division – This division derives its funding from three main sources.
 - When the division collects payments for a TANF recipient family, the division keeps a portion and a portion is returned to the federal government. These funds, along with federal matching funds, are used to fund the division
 - Federal incentive funds, which are received for meeting certain performance standards, are matched with additional federal funds
 - General fund has been appropriated to the division to supplement the other state and federal revenues

The 2003 Legislature also added tobacco settlement funds to supplement the division due to reduced TANF caseloads and the loss of a portion of the previously assumed level of incentive funds. These factors continue in the 2005 biennium, and the executive seeks a supplemental appropriation to offset losses in TANF collections and federal incentive revenues.

2. Foster care – The federal government shares in the cost of care for any child who enters the foster care system and meets the eligibility criteria contained in section IV-E of the Social Security Act. Because state costs of care are lowered whenever a child is determined IV-E eligible, the state pursues certification whenever possible. The number deemed eligible was recently reduced significantly from the number assumed when the appropriation was made due to two primary factors:

- An internal audit by the department
- Audits and tightening requirements by the federal government

As a result, the general fund must assume a greater percentage of the cost of care for more children. The total shortfall is estimated at \$3.7 million, with the remaining \$2.6 million mitigated with internal reductions.

FIRE COSTS

Montana does not appropriate funds for future fire costs. Instead, any costs incurred by state government (the Department of Natural Resources and Conservation and the Department of Military Affairs) are paid by the agencies as they become due, and the legislature then provides a supplemental appropriation to both pay all outstanding claims and to reimburse the agency[s] for any costs already paid. Consequently, each legislative session the legislature is asked to provide a supplemental appropriation to pay for all state costs of fighting fires in the current biennium. Although fire costs in FY 2005 were well below average, Montana had a severe fire season in FY 2004. Total costs over the biennium were almost \$84 million, of which over \$35 million was the responsibility of the state general fund. However, as shown in the Figure 3, the executive is not requesting any supplemental appropriation for fire costs in the 2005 biennium, a situation that, as shown in Figure 3, is unprecedented.

Figure 3
Supplemental Appropriations for Fire Suppression
1983 to 2005 Biennium

Biennium	Supplemental Appropriation	Statutory Appropriations	Total
1983	\$0.80	\$0.00	\$0.80
1985	2.90		2.90
1987	3.74		3.74
1989	12.64		12.64
1991	3.00	0.50	3.50
1993	7.94	1.96	9.90
1995	15.50	8.92	24.42
1997	4.47	3.10	7.57
1999	10.55		10.55
2001	33.22	6.20	39.42
2003	9.07	7.01	16.08
2005	0	0	0

The reason for this anomaly was the passage by Congress of the Jobs and Growth Tax Relief Reconciliation Act of 2003 in June 2003. One part of this act was a \$25 million per year (total \$50 million) grant to the state. This grant had very few requirements, and the Governor chose to set aside a significant portion for the costs of fighting fires. Given the mild FY 2005 fire season, funds set aside by the Governor for this purpose are sufficient to pay all current and anticipated fire costs in the 2005 biennium. Without this grant, the supplemental request proposed by the executive would have been higher by a like amount. A further discussion of the Jobs and Growth Tax Relief Reconciliation Act of 2003 begins on page 134 of this report.

EXECUTIVE PAY PLAN PROPOSAL

While the executive has not completed a negotiated state employee pay plan, a request for funding for a pay plan increase is included in the executive budget.

The executive has submitted legislation for a pay plan for the 2007 biennium in two primary parts:

- An increase in per employee insurance contributions of \$46 per month beginning January 1, 2006 and an additional \$51 per month beginning January 1, 2007. The same increases are applied to the university system employees beginning July 1 of each year
- A 3 percent per year salary increase beginning October 1 each year

The executive is also recommending that the legislature fund a personal services contingency for distribution to agencies that cannot meet vacancy savings targets and a small training allowance. With the exception of insurance contributions, which are fully funded, the executive applies a 4 percent vacancy savings rate to the funding calculations.

The legislation includes the following appropriations (detailed in Figure 4):

- \$31.5 million general fund and \$31.5 million other funds (\$63.0 million total funds) for the pay plan and insurance increase
- \$1.5 million general fund and \$3.0 million other funds for a personal services contingency
- \$75,000 general fund for a training allowance

Figure 4
Proposed Pay Plan Appropriation - Executive Budget
2007 Biennium

Entity	--- Fiscal 2006 ---			--- Fiscal 2007 ---			--- 2007 Biennium ---		
	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
Legislative Branch	\$177,219	\$15,802	\$193,021	\$444,838	\$39,532	\$484,370	\$622,057	\$55,334	\$677,391
Consumer Counsel	0	10,254	10,254	0	25,342	25,342			0
Judiciary	520,470	18,381	538,851	1,303,340	45,957	1,349,297	1,823,810	64,338	1,888,148
Executive Branch	4,662,443	7,938,840	12,601,283	11,907,644	20,096,049	32,003,693	16,570,087	28,034,889	44,604,976
University System	<u>3,360,580</u>	<u>108,790</u>	<u>3,469,370</u>	<u>7,592,508</u>	<u>241,249</u>	<u>7,833,757</u>	<u>10,953,088</u>	<u>350,039</u>	<u>11,303,127</u>
Total	\$8,720,712	\$8,092,067	\$16,812,779	\$21,248,330	\$20,448,129	\$41,696,459	\$29,969,042	\$28,504,600	\$58,473,642
Training Allowance*	\$75,000		\$75,000				\$75,000	\$0	\$75,000
Personal Services Contingency*	1,500,000	3,000,000	4,500,000				<u>1,500,000</u>	<u>3,000,000</u>	<u>4,500,000</u>
Total Proposed Appropriation	<u>\$10,295,712</u>	<u>\$11,092,067</u>	<u>\$21,387,779</u>	<u>\$21,248,330</u>	<u>\$20,448,129</u>	<u>\$41,696,459</u>	<u>\$31,469,042</u>	<u>\$31,504,600</u>	<u>\$62,973,642</u>

*Biennial appropriations

In addition, the executive is proposing to combine the current teachers' and blue-collar pay classifications into the primary state pay classifications.

INSURANCE INCREASE

The employer contribution to the health insurance costs of employees is increased 10 percent each year, to \$506 per month beginning January 1, 2006, and to \$557 per month beginning January 1, 2007 or most state employees. University system increases are effective July 1 of each year.

**LFD
ISSUE**

In determining the level of premium for employee health insurance, a \$10 per month reserve component was not included, as has occurred in the past. The reserve amount would provide a buffer in the event actual claims exceed projections. In the past, this \$10 reserve was incorporated into the state contribution toward the premium amount each month. Without the reserve, and with unpredictable claims activity, there is increased risk that adjustments to the health insurance plan may need to occur during the biennium to maintain its fiscal solvency. The burden created by any adjustments due to higher than projected claims activity would fall on the employee through increased premium, higher deductibles, or higher co-pays.

SALARY INCREASE

The executive proposes to increase state employee salaries by 3 percent each year of the biennium, beginning on October 1.

FUTURE COSTS

Because the pay and insurance increases are phased in over the biennium, costs in the next biennium for this pay plan will be significantly higher - \$48.8 million general fund and \$97.4 million other funds (excluding positions for which the legislature does not appropriate funds).

PERSONAL SERVICES CONTINGENCY

The executive is proposing a contingency pool of \$1.5 million general fund and \$3 million other funds. The funds would be allocated by the Office of Budget and Program Planning to agencies when personnel vacancies do not occur, retirement costs exceed agency resources, or other contingencies arise.

The legislature has appropriated funds for this purpose for several biennia.² In the 2005 biennium, the legislature appropriated \$1.5 million general fund and \$3.0 million other funds as a contingency. A total of \$450,049 general fund and \$633,132 other funds had been spent from the contingency as of the writing of this report. The largest recipient of the funding was the Department of Corrections, which received \$300,000 general fund and \$606,256 other funds. The institutions in the Department of Public Health and Human Services received funding from the temporary federal Jobs and Growth Tax Relief Reconciliation Act of 2003 to reduce vacancy savings.

OTHER ISSUES

Military Deployments

Numerous Montana state employees who are also members of the national guard or other reserve units, have been called to duty for periods often times in excess of one year and for as long as two or more years. From a state fiscal perspective, there are potential impacts that need to be kept in mind relative to the budget. While there might be an expectation of increased vacancy savings for individual

² For a complete history of vacancy savings assumptions and contingency appropriations, see the Vacancy Savings narrative in this volume.

agencies, this is not necessarily the case, as agencies tend to fill these positions with temporary replacements. Many positions fall into the category of being “24/7” coverage positions, and agencies cannot afford to leave them vacant. Therefore, a decrease in costs resulting from the deployments is not necessarily a reliable expectation.

On the other hand, when a deployed soldier returns, he or she has certain rights that might increase costs for state agencies. Under the Uniformed Services Employment and Reemployment Rights Act (USERRA), for example, a returning soldier can purchase the service time that he or she would have earned if working. If that employee pays the cost of his or her share of the retirement costs, then the state as employer must pay its cost. There is no way to anticipate how many returning soldiers will do this, but the potential is there.

Costs can vary in other ways also. Temporary replacements would typically be hired at entry rates, so costs might be lower. On the other hand, if a replacement is not found, overtime costs might come into play, resulting in higher costs.

Broadbanding

The state is facing major challenges in the area of human resources in the short and long-term. The state government workforce is aging, and a significant percentage of state employees, representing many years of experience, are nearing retirement age. At the same time, the number of workers to take their place is not keeping pace. The state faces the real possibility not only of a great loss of expertise, but of having to replace those experienced workers with less experienced personnel at salary levels that reflect high demand.

In part as a means of addressing this reality, the state has embarked upon a means of classifying and paying personnel called a broadband pay plan, which is part of a larger human resource classification and pay initiative called the Montana Human Resources Competency Project. Instead of employees being in one of a number of narrowly defined “bands” for purposes of determining pay, the bands are widened to allow greater flexibility to managers to adjust duties and pay within the band. Certain agencies have made conversions to broadbanding for significant numbers of employees. The executive has stated it has a tentative timetable to move all state employees to a broadband pay system by the end of the 2007 biennium.

The initial banded pay plan was implemented in part because of concerns that employees with similar skills and responsibilities were being paid at significantly different levels among agencies of state government. In part in order to increase equity, the legislature originally established a pay plan with fairly narrow pay bands and specific job requirements. While broadbanding allows for greater flexibility, particularly in those positions with specialized, high demand skills where recruiting and retaining employees is an issue, broadbanding can also have equity consequences within state government that the initial pay plan was in part implemented to address.

- In order to be effective, there must be funding to implement and maintain broadbanding over time. Therefore, an agency's ability to use broadbanding to best effect may be limited by funding. Agencies with little or no general fund and/or stable non-general fund sources of funding (state special, federal, and proprietary revenue) will be at an advantage over agencies with either significant general fund and/or a more limited non-general fund source of funding

- Some agencies have more funding flexibility than others, and could conceivably use broadbanding more effectively. This situation not only creates inequities between and among agencies, it can actually increase turnover in agencies that cannot compete in salaries with other agencies

In addition, with broadbanding the legislative pay plan is a major but potentially ever smaller part of the determination of how much a state employee is paid. While the pay plan is still an extremely important determinate of most state employees' wage adjustment (and all of the insurance adjustment), a greater share of personal services is determined outside of the direct legislative appropriations process.

The legislature may wish to examine broadbanding more thoroughly during the interim to address these and other questions:

- How is broadbanding impacting the state's ability to recruit and retain employees
- How does the administration plan to address the actual and potential fairness issues among agencies of state government as broadbanding becomes the norm--can broadbanding be made more equitable among agencies both as a general employee fairness issue, and to reduce other issues of recruitment and retention between and among agencies
- How can the pay plan addressed by each legislative session more effectively take into account broadbanding and its effect on pay levels
- What impact is broadbanding having on the state personal services budget

Medical Cost Increases

All state governments, and Montana is no exception, deal with the impact of rising medical costs. Nationally, it is estimated that 10 percent of state expenditures are for medical costs, which include payments for state employee health benefits, Medicaid services, state Children's Health Insurance Programs (CHIP), and medical services provided by and paid for by state institutions. The legislature may wish to study whether there is a way for state funded health services to either be combined or to learn from each plan's cost control methods for Montana to realize savings.

PERSONAL SERVICES ISSUES

Personal services represents the costs of salaries and benefits for state employees, and represents nearly 40 percent of total state agency operating costs (excluding grants and benefits, capital outlay, and transfers). The following discussion addresses two major components of personal services, total FTE and Vacancy Savings.

FTE IMPACTS

The proposed executive budget will have an impact on the number of state government FTE (full-time equivalent employees). As shown in Figure 5, total FTE would increase over the FY 2004 level by 106.09 in FY 2006 and 91.16 in FY 2007 (reduction of 14.93 from FY 2006).

Figure 5					
Total Proposed FTE Levels 2007 Biennium Executive Budget					
Section/Agency	Base Fiscal 2004	Net Change Fiscal 2006	Total Fiscal 2006	Net Change Fiscal 2007	Total Fiscal 2007
Section A*					
Legislative Branch**	124.77	0.20	124.97	5.37	130.14
Consumer Counsel	5.04	0.00	5.04	0.00	5.04
Judiciary	374.68	(12.55)	362.13	(12.55)	362.13
Governor's Office	60.00	(0.43)	59.57	(0.43)	59.57
Commissioner of Political Practices	5.00	(1.00)	4.00	(1.00)	4.00
State Auditor	71.50	2.00	73.50	2.00	73.50
Transportation	2,176.13	54.28	2,230.41	29.15	2,205.28
Revenue	609.53	2.55	612.08	2.50	612.03
Administration	151.07	6.65	157.72	6.65	157.72
Appellate Defender	3.00	0.00	3.00	0.00	3.00
Consensus Council	2.00	0.00	2.00	0.00	2.00
Section B					
Public Health and Human Services	2,755.01	(25.83)	2,729.18	(15.83)	2,739.18
Section C					
Fish, Wildlife, Parks	623.44	30.36	653.80	21.53	644.97
Environmental Quality	355.03	19.50	374.53	19.50	374.53
Livestock	145.49	(10.50)	134.99	(10.50)	134.99
Natural Resources and Conservation	486.24	4.00	490.24	4.00	490.24
Agriculture	111.54	2.00	113.54	2.50	114.04
Commerce	47.00	(5.34)	41.66	(5.34)	41.66
Section D					
Public Service Commission	39.00	0.00	39.00	0.00	39.00
Crime Control	19.00	2.00	21.00	2.00	21.00
Justice	710.60	(1.63)	708.97	(2.77)	707.83
Corrections	1,095.05	10.70	1,105.75	14.70	1,109.75
Labor/Industry	707.48	6.60	714.08	6.60	714.08
Military Affairs	168.90	5.00	173.90	5.00	173.90
Section E					
Office of Public Instruction	125.31	5.35	130.66	5.90	131.21
Board of Public Education	4.00	0.00	4.00	0.00	4.00
MT. School for the Deaf and Blind	81.68	(0.73)	80.95	(0.73)	80.95
Commissioner of Higher Education***	90.05	12.00	102.05	12.00	102.05
Arts Council	7.00	0.00	7.00	0.00	7.00
State Library	28.50	1.00	29.50	1.00	29.50
Historical Society	57.68	(0.09)	57.59	(0.09)	57.59
Totals	<u>11,240.72</u>	<u>106.09</u>	<u>11,346.81</u>	<u>91.16</u>	<u>11,331.88</u>
*Secretary of State FTE are all supported with proprietary funds.					
**FY 2007 includes session staff.					
***Includes only staff from the Commissioner of Higher Education office.					

These increases are the net of a number of proposed increases and decreases in FTE.

Major Increases

The following summarizes the major increases in FTE recommended by the Governor. For a further discussion, see the individual agency narratives in Volumes 3 and 4 of the Budget Analysis.

- Montana Department of Transportation – FTE are added or subtracted in conformance with the construction plan for any given biennium, this increase primarily reflects increased construction and engineering activity anticipated in the 2007 biennium
- Department of Fish, Wildlife, and Parks – FTE would increase in significant part due to a conversion of the automated licensing system from contracted services to in-house FTE, and to miscellaneous new initiatives
- Department of Environmental Quality – FTE would increase for two reasons:
 1. To provide additional staff for the total maximum daily load (TMDL) project as the court ordered deadline approaches; and
 2. To provide assistance in numerous functions with current workload issues
- Department of Corrections – FTE staff increase due to an increase in probation and parole staff. (Most cost increases in the department are in contract facilities such as pre-release centers and the private and regional prisons, rather than through the addition of state FTE)
- Office of Public Instruction – FTE would increase due to increases in projects/programs funded by federal grants
- Commissioner of Higher Education (Montana University System) – FTE in the commissioner's office increase due to increased activity in the Guaranteed Student Loan Program, and the addition of staff to support the Shared Leadership Project initiatives

Major Reductions

There are three main reductions included in the totals.

- Judiciary – The primary cause of the net reduction in the Judiciary is due to the sunset of statute authorizing a surcharge of \$10 on case filings in courts of original jurisdiction, which had funded information technology initiatives in Montana courts. As of this writing, the Judiciary planned to request that the legislature fund this function with general fund. For a further discussion, see the Judiciary narrative in Volume 3, page A-28.
- Department of Livestock - The Department of Livestock is primarily funded with revenue from assessments on livestock. As the number of livestock have declined, so has revenue to operate the department, resulting in a reduction of FTE. For a further discussion, see the Department of Livestock narrative in Volume 4, page C-89.
- Statewide FTE Reductions - The 2003 Legislature imposed an additional, cumulative vacancy savings rate of about 2 percent on general funded positions as a budget saving measure. Because the legislature did not identify any positions associated with the reduced vacancy savings, all 2005 biennium reductions were fully funded in the 2007 biennium initial budget determination. With limited exceptions, agencies with FTE supported with general fund and under the jurisdiction of the Governor (as well as the Judiciary) are reduced in the 2007 biennium executive budget by an amount equivalent to the prior reduction in order to make those reductions permanent. These reductions total 55.00 FTE in the executive branch and 5.00 FTE in the Judiciary.

Statewide FTE Reduction

The legislature does not “approve” or “disapprove” the level of FTE in each agency. Rather, the legislature determines which FTE will be funded in the current biennium, and which can be used to determine present law personal services in the next biennium. Therefore, the number of FTE is a very important part of budget determination. As stated, the Governor proposes to permanently remove some FTE from current and future personal services budget determination as a means to make the 2005 biennium budget reduction permanent.

Figure 6 details the statewide personal services adjustment and FTE reduction recommended by the Governor, by agency. As shown in the figure, several agencies were exempt. The exemptions were generally due to four conditions:

- Legislative branch because the Governor must accept the budget as submitted due to separation of powers issues
- Agencies with a small number of FTE
- Agencies that took the initial 2005 biennium reduction in operating expenses, meaning that the 2005 biennium reduction carried forward into the 2007 biennium
- Other miscellaneous exemptions

Reductions imposed on the agencies shown in the figure essentially mirror the general fund reduction enacted by the 2003 Legislature, with two major exceptions: 1) the Department of Public Health and Human Services; and 2) the Department of Corrections. The 2003 Legislature calculated the reduction based upon an average cost per FTE across agencies, rather than within each agency. As a result, agencies with an overall lower average salary, such as DPHHS and corrections, had a generally higher overall percentage reduction than agencies with an overall higher average salary. In addition, agencies with positions that had to be filled 24 hours a day, 7 days a week were not exempted from the 2005 biennium reduction. The Governor has adjusted the reduction in the 2007 biennium primarily to recognize the 24/7 positions.

Figure 6				
Statewide FTE Reductions				
2007 Biennium Executive Budget				
Section/Agency	Biennial FTE Reduction	Biennial General Fund Reduction	Percent FTE Reduction	Additional General Fund Reduction
Section A*				
Legislative Branch	0.00	\$0	---	---
Consumer Counsel+	0.00	0	---	---
Judiciary	5.00	510,916	1.3%	1.2%
Governor's Office	0.79	85,875	1.3%	1.2%
Commissioner of Political Practices**			---	---
State Auditor+	0.00	0	---	---
Transportation+	0.00	0	---	---
Revenue	9.50	871,318	1.6%	1.8%
Administration	1.50	117,788	1.0%	0.7%
Appellate Defender	0.00	0	---	---
Consensus Council+	0.00	0	---	---
Section B				
Public Health and Human Services	29.03	1,613,571	1.1%	0.6%
Section C				
Fish, Wildlife, Parks+	0.00	0	---	---
Environmental Quality	1.00	83,724	0.3%	0.2%
Livestock	0.00	0	---	---
Natural Resources and Conservation	0.00	0	---	---
Agriculture	0.00	0	---	---
Commerce***	0.34	27,959	0.7%	0.6%
Section D				
Public Service Commission+	0.00	0	---	---
Crime Control	0.00	0	---	---
Justice	4.52	491,410	0.6%	0.7%
Corrections	4.30	438,684	0.4%	0.5%
Labor/Industry	0.40	38,201	0.1%	0.1%
Military Affairs	0.00	0	---	---
Section E				
Office of Public Instruction	1.55	97,403	1.2%	0.7%
Board of Public Education	0.00	0	---	---
MT. School for the Deaf and Blind	0.73	62,587	0.9%	0.8%
Commissioner of Higher Education****	0.50	45,074	0.6%	0.5%
Arts Council	0.00	0	---	---
State Library	0.00	0	---	---
Historical Society	0.84	52,696	1.5%	1.0%
Totals	60.00	\$4,537,206	0.5%	0.4%

*Secretary of State FTE are all supported with proprietary funds.

**Part of a larger reduction due to an extended vacancy.

***Does not include 3.0 FTE reallocated to a statutory appropriation

****Includes only staff from the Commissioner of Higher Education office.

+No general fund in the agency

**LFD
ISSUE**

Some agencies have preliminarily identified which positions would be targeted while others have not. In addition, the FTE identified for elimination may not coincide with legislative priorities. The legislature may wish to examine the reductions proposed in each agency during budget deliberations to determine:

- What services, if any, would be reduced
- What impact the reduction might have on expenses in other areas of state government or within the individual departments, or on other governmental entities
- Whether reduction of the FTE would have any impact on the receipt of federal funds, or on state revenue collections
- What other reduction options may be possible

VACANCY SAVINGS

Vacancy Savings is the difference between the cost of fully funding a position for the entire year and the actual cost of authorized employee positions during that period. A vacancy savings reduction, usually a percentage reduction from full funding, has been applied to budgets in prior years in recognition of the fact that staff turnover and vacancies often result in personal services expenditures lower than appropriated. This section outlines the executive's proposal for vacancy savings.

Executive Proposed Vacancy Savings

The executive has applied a 4 percent vacancy savings rate to all personal services including insurance contributions. The rate is applied to all positions in state government with the following exceptions.

- Agencies with fewer than 20 FTE
- University system faculty
- Elected officials
- The legislative branch
- The judicial branch

The executive has applied vacancy savings to on-going positions and those proposed for inclusion by present law adjustments or new proposals. Vacancy savings reductions total \$49 million over the 2007 biennium, of an estimated impact of \$19.1 million is general fund. Of the \$49 million, \$40.2 million is from state government (excluding the university system) and \$8.8 million is from the university system.

Personal Services Contingency

In order to assist agencies that have insufficient authority to meet all personal services costs in the 2007 biennium, the executive is proposing, in the pay plan bill, a contingency fund including \$1.5 million general fund and \$3.0 million other funds. Agencies experiencing this problem would have to apply to the Office of Budget and Program Planning for these funds during the biennium.

PENSION FUND - UNFUNDED LIABILITIES

EXECUTIVE RECOMMENDATIONS

The most recent actuarial valuations of the state pension funds were completed for the period ending July 1, 2004, and have determined that the plans have unfunded liabilities that exceed the statutory 30-year amortization period for funding. The current unfunded liabilities are primarily due to market losses on the investment of pension funds. Pension funds in most states are experiencing significant unfunded liabilities due to investment losses. The state as employer is liable for the solvency of the funds.

The executive recommends legislation to actuarially fund various public employee retirement systems. An estimate in the executive budget of \$7.2 million general fund for the biennium would fund the first of a two-biennium phase-in of state contribution increases for the retirement systems for public employees (PERS), teachers (TRS), game wardens and peace officers (GWPORS), and sheriffs (SRS). The state contribution increases, along with system design changes that would impact employees hired after July 1, 2005, are proposed to address significant unfunded liabilities of the plans.

Public Employees' Retirement Systems

Executive recommendations to address the unfunded liabilities of plans under the Public Employees' Retirement Board (PERB) include the employer contribution increases shown in Figure 7 and system design changes. System design changes include the following for workers hired after July 1, 2005:

- Change the definition of final average salary from a 3-year to a 5-year average
- Cap the guaranteed annual benefit adjustment at the consumer price index for urban wage earners and workers (it is currently 3 percent)

Figure 7 Public Employee Retirement Board Employer Contribution (percentage of total employee compensation)			
Plan	Current Rate	New Rates	
		2007 Biennium	2009 Biennium
PERS	6.9	7.56	8.23
GWPORS	9.0	10.20	11.40
SRS	9.5	9.74	9.74

LFD COMMENT

Subsequent to the executive budget being released, the PERB has approved the employer contribution increase, but withdrawn the plan changes mentioned above for workers hired after July 1, 2005. The legislation (LC 96) to actuarially fund the plans under the PERB reflects the decisions of the board.

Estimates based on FY 2004 expenditures and funding indicate a \$2.5 million general fund impact in the 2007 biennium. Because the employer contribution increases are phased in over two biennia, the impact would be doubled in the 2009 biennium and remain at that rate each biennium thereafter, until the provision included in the legislation allows the PERB to lower the contribution rate to the current level (after an actuarial valuation determines the period required to amortize the system's unfunded liabilities is less than 25 years).

**LFD
COMMENT**

The actuarial valuation used to determine the recommended contribution increases indicate that the increases would only continue for three biennia before the unfunded liabilities are less than the 25-year amortization period and the rates can be returned to their current levels.

The general fund impact for the 2009 biennium would be an additional \$2.5 million above the 2007 biennium increase. Once the full rate increase is implemented, the \$5.0 million increase above the current biennium would continue for each biennium until the rate is returned to the current level and the unfunded liabilities are reduced to within the 25-year amortization period.

Teachers' Retirement System

Recommendations to address the unfunded liabilities of plans under the Teachers' Retirement System Board (TRB) include the employer contribution increases of shown on Figure 8 and system design changes. System design changes include the following for workers hired after July 1, 2005:

- Change the definition of final average salary from a 3-year to a 5-year average
- Change the normal retirement age for those with 5 or more years and who have attained the age of 60, from 25 to 30 years of service
- Change the early retirement age for those with 5 or more years of service from 50 to 55 years

Estimates based on FY 2004 expenditures and funding indicate a \$4.4 million general fund impact in the 2007 biennium. As with the PERS increases, the employer contribution increases are phased in over two biennia. As such, the impact would be doubled in the 2009 biennium and remain at that level of increase above the current contribution level for each biennium thereafter, until the provision included in the legislation (LC 100) determines the period required to amortize the system's unfunded liabilities is less than 25 years and the TRB lowers the contribution rate back to the current rate.

Figure 8 Teachers' Retirement Board Employer Contribution (percentage of total employee compensation)			
Plan	Current Rate	New Rates	
		2007 Biennium	2009 Biennium
TRS	7.47	8.67	9.87
University system optional retirement program	4.04	4.60	5.16

**LFD
COMMENT**

The general fund impact for the 2009 biennium would be an additional \$4.4 million above the 2007 biennium increase. Once the full rate increase is implemented, the \$8.8 million increase above the current biennium would continue for each biennium until the unfunded liabilities are reduced to within the 25-year amortization period and the rate is returned to the current rate.

**LFD
ISSUE**

Impacts of Member Demographics

The most recent actuarial valuation indicates that the average annual salary, age, and years of service for active members continue to increase from previous actuarial valuations. At the same time, the total number of contributing members has declined since the 2002 valuation. The legislature may want to ask how an aging workforce with higher termination salaries would impact plan costs, contributions, and future funding of liabilities when the current workforce is replaced with a younger workforce potentially earning lower salaries.

FEE CHANGES

Fee changes are often proposed by the executive as a means to do either of the following:

- Shift all or a part of the cost of functions from one funding source to another. These shifts can be done in order to ensure that those receiving the service are the persons paying for it, or a re-examination of the relationship between those who currently pay and the service; and/or
- Provide additional resources either to meet rising costs, address lower revenues, or begin new initiatives.

EXECUTIVE RECOMMENDATION

In the 2007 biennium, the executive proposes five fee changes in HB 2.

Figure 9
Fee Increases
Executive Budget
2007 Biennium

Agency/Program	--- General Fund ---		--- Other Funds ---		Explanation
	2006	2007	2006	2007	
Administration			\$1,400,833	\$1,401,336	Increased fees for recording land transaction documents by \$1 per page to develop a standardized, sustainable method to collect, maintain, and disseminate information in digital formats about the natural and man-made land characteristics of Montana (LC 79)
Justice	158,000	159,000			Fees for pathology services in the Forensic Science Division
DEQ/Permitting			166,732	157,278	Increased fees for hardrock mines. \$500 application, \$100 for renewal/exploration \$100 application, \$50 renewal
DEQ/Permitting			23,350	23,350	Septage fees increased to \$250 (HB77)
DEQ/Centralized Serv.			250,000	250,000	Increase in Montana Environmental Policy Act fees for environmental impact statements (LC1309)
Total	\$158,000	\$159,000	\$1,840,915	\$1,831,964	

The list above does not include one additional change proposed in the executive budget.

- The Judiciary would add state staff for remediation work currently done by private entities, and charge the parties involved for the service. General fund of \$218,159 is included in the budget to fund the positions, and any revenues collected would be deposited to the general fund.

The following fee related issues are also noted for informational purposes.

- The Department of Fish, Wildlife, and Parks has proposed increases in resident conservation license fees. Governor Martz has authorized the department to request the increase, but the submitted budget does not incorporate any increased revenues into the totals requested.
- The Law Enforcement Academy in the Department of Justice is funded with a surcharge of \$10 made by the courts of limited jurisdiction on certain criminal convictions. Funds were not collected at the level anticipated and the department has indicated it may seek an increase in fees.
- The Board of Livestock has increased certain fees to producers in an attempt to maintain collection levels for fees that fund most operations of the Department of Livestock. Because the fees are based upon head of livestock and most livestock counts are decreasing, revenues to fund the department are also decreasing.

- The executive budget includes a number of increases for ongoing operational expenses of the Montana University System. These expenses are funded with state appropriations (general fund, 6 mill levy, and minor other), and with non-appropriated tuition. In addition, the executive is proposing a pay plan that would include the Montana University System and be partially funded with tuition. Tuition is a user fee for students, and any increase in tuition is a fee increase. The executive funded the on-going operational increases with a greater share of general fund than the historical level, with the goal of reducing potential tuition increases. The executive has stated that it anticipated a tuition increase of no more than 2 percent would be needed to fund the proposed increases. The Montana University System at the November Board of Regents meeting estimated tuition increases of over 4 percent each year to fund the executive budget.
- Court automation costs in the Judiciary are funded with a surcharge of \$10 on filings in courts of original jurisdiction. This surcharge was increased from the historical \$5 by the 2003 Legislature to provide additional funds for the court automation effort, and expires at the end of the 2005 biennium. This would represent a fee decrease. The Judiciary is requesting that court automation be funded with general fund in the 2007 biennium. For a further discussion, see page A-28 in Volume 3.

FUND SWITCHES

The executive has included a number of funding switches in the executive budget. Due to unique circumstances, the funding switches increase general fund expenditures by over \$7.0 million in the 2007 biennium, as shown in the Figure 10.

Figure 10
Fund Switches
Executive Budget
2007 Biennium

Agency/Program	--- General Fund ---		--- Other Funds ---		Explanation
	2006	2007	2006	2007	
University System	\$2,660,000	\$2,660,000	(\$2,660,000)	(\$2,660,000)	Funding of various increases with 80 percent general fund, rather than historical 43 percent
Labor and Industry	613,665	611,535	(613,665)	(611,665)	Replace employment security funds with general fund for various programs
Judiciary	112,396	105,763	0	0	Supreme Court to hire 1.50 FTE for appellate mediator services currently being accomplished by private sector
Justice	61,503	61,430	(61,503)	(61,430)	1.00 FTE Chemist federally funded position to be funded with general fund due to expiration of federal grant
Justice	61,503	61,430	(61,503)	(61,430)	1.00 FTE Serologist/DNA federally funded position to be funded with general fund due to grant expiration
Total	<u>\$3,509,067</u>	<u>\$3,500,158</u>	<u>(\$3,396,671)</u>	<u>(\$3,394,525)</u>	

University System - The legislature appropriates general fund and six-mill levy revenue for a portion of the general operating expenses of the Montana University System, with tuition making up the bulk of the difference between the legislative appropriation and total expenditures. The Governor has recommended a higher level of general fund for recommended increases for statewide present law adjustments and enrollment increases than historically utilized. The Governor's stated goal is to minimize tuition increases. For a further discussion, see the Montana University System narrative in Volume 4 of the Legislative Fiscal Division Budget Analysis, page E-129.

Labor and Industry - The 2003 Legislature temporarily replaced general fund in several programs in the Department of Labor and Industry with employment security account (ESA) funds. ESA funds are derived from an assessment on all employers in the state. The funds were made available due to the one-time allocation to the state of additional federal funds, which replaced ESA funds in several programs, which then freed up the ESA. While the 2003 Legislature had made the allocation temporary, all uses fall within statutory guidelines and the ESA could continue to fund several of these programs. The executive budget, however, recommends returning support for some programs to the general fund. For a further discussion, see the Department of Labor and Industry narrative in Volume 4 of the Legislative Fiscal Division Budget Analysis, page D-121.

Judiciary - The executive is requesting general fund for the biennium to hire 1.50 FTE to provide mediation services. These FTE would select which appeals to mediate in order to reduce the number of mediations and improve the overall success rate. Further, parties to those cases selected for mediation would be required, as they presently are, to share the mediator's costs. This function is currently provided entirely by the private sector.

Justice - The executive is requesting general fund to hire 1.00 FTE as a chemist in the Forensic Science Division of the Department of Justice. This FTE would keep the current number of chemists at four, as this FTE would replace with general fund a position that is currently funded with federal funds that expire on June 30, 2005. The executive is also requesting general fund for 1.00 FTE Serologist/DNA. This position would keep the current number of serologists at four, as it changes the funding of 1.00 FTE to general fund from the current federal funds, which expire on June 30, 2005.

A major change in funding is not included in Figure 10 because it is not considered a traditional fund switch, but which has a significant impact, is in the Department of Public Health and Human Services (DPHHS), and is due to two factors that impact the percentage of total Medicaid benefit costs the state will pay. The combined impact is to increase general fund by \$55 million over the biennium and reduce federal funds by a like amount.

1. The federal government adjusts the federal Medicaid match rate each year based upon Montana's income growth compared to the national average. Because Montana's rate exceeded the national average, the percentage of Medicaid benefits costs the federal government will pay has gone down. As a result, in order to provide the same level of service, the general fund must be increased.
2. In FY 2003, as part of the provision of fiscal relief to states, the federal government increased the federal participation match rate for a portion of FY 2003 and all of FY 2004. Therefore, FY 2004 expenditures for Medicaid reflect the temporary fiscal relief. If the state provides the same level of services, the general fund must replace this reduced federal funding.

Each proposed funding switch is discussed in more detail in the individual agency narratives in Volumes 3 and 4.

ONE-TIME EXPENDITURES

The executive proposes over \$94 million in one-time expenditures. This is an unusually high amount of one-time proposals, and reflects the Governor's priorities for using one-time revenues from a high beginning general fund balance for one-time purposes, in order to maintain structural balance in the general fund. These one-time expenditures are in HB 2, other legislation, and proposed transfers as noted in Figure 11. The following details each of the proposed increases, using the categories noted by the executive.

Figure 11 One-Time Only Expenditures Executive Proposal - 2007 Biennium (Dollars in Millions)				
Expenditure Description	Biennial Amount	In HB 2?	HB 2 Agency	Analysis Page #
<u>Pay Off Debts</u>				
Pay off the Dept of Revenue computer system (IRIS phase I & II)	\$16.00	Y	Revenue	A-152
Replace Cultural Trust revenue used to buy Virginia/Nevada Cities	3.91	N	---	---
Completing payments for the Crow Tribe Water Compact Agreement*	7.00	Y	DNRC	C-142
<u>Deferred Maintenance & Other Capital Needs</u>	30.00	N	---	Section F
<u>Investment in Information Technology Infrastructure</u>				
Completion of POINTS computer system replacement	4.00	Y	Revenue	A-152
Computer system to track offenders	1.60	Y	Corrections	D-81
Property tax system replacement	5.50	Y	Revenue	A-173
Judiciary computer system completion	1.35	Y	Judiciary	A-28
Gambling Control computer system	1.10	Y	Justice	D-22
<u>Preparing for the Future</u>				
Northern Tier Emergency Telecommunications Infrastructure completion	4.10	Y	Administration	A-218
Dept of Revenue protested property tax reserve	4.00	N	---	---
Agricultural land reevaluation	1.40	Y	Revenue	A-173
Shared Leadership	3.94	Y	University System	E-132
<u>Equipment Needs</u>				
Equipment for two year programs	5.00	Y	University System	E-134
<u>Other</u>				
License plate issue manufacturing costs	4.35	Y	Corrections	D-104
Total Maximum Daily Load (TMDL) completion	0.33	Y	Environmental Quality	C-53
Pay federal government for workers' compensation transfer	0.22	N	Administration	A-178
Audiology equipment	0.17	Y	Office of Public Instruction	E-11
Purchase helicopter	0.20	Y	DNRC	C-156
Miscellaneous other computers, security, phones, grants, studies	0.34	Y	Various	---
Total One-Time Only Expenditures**	<u>\$94.50</u>			
*The Governor lists this increase as \$9.0 million. However, \$2.0 million is removed from the base for a total net of \$7.0 million				
**Governor lists an additional \$2.0 million. Difference is the Crow Tribe net noted above.				

Each of the proposed HB 2 increases is discussed in further detail in the appropriate agency narrative in either Volume 3 or Volume 4, as referenced in the far right column in the above figure. The property tax reserve is discussed on page 125 and the transfer to the cultural trust and the deferred maintenance and other capital needs proposal are discussed on page 102. In addition, the following are noted regarding these proposals.

1. The payment to the federal government for refunded workers' compensation transfers may not be necessary. For a further discussion, see page A-178 in Volume 3.
2. A re-engineering effort may be required before further state resources are committed to the Judiciary's computer upgrade. For a further discussion, see page A-28 in Volume 3.
3. The executive funds total maximum daily load expenditures with both one-time and on-going funds. However, the department has had significant issues with retaining qualified staff to complete the work. For a further discussion, see page C-53 in Volume 4.
4. The Gambling Control Division and Department of Corrections computer systems would replace systems plagued with development and/or implementation problems, and the legislature may wish to closely monitor activities in the 2007 biennium. For a further discussion, see pages D-22 and D-81 in Volume 4.
5. The helicopter purchase in DNRC is primarily to aid in fire suppression. A recent audit indicates that, while additional helicopters would aid in responding quickly to fires, the department is not able to use them to highest effectiveness because of a lack of pilots. Therefore, the legislature may wish to ask the department how the helicopters will be used and what efforts are underway to ensure that pilots will be available to fly them.
6. The legislature may wish to monitor and/or help articulate goals and measures of progress for the Shared Leadership project. For a further discussion, see page E-132 in Volume 4.
7. Two of the proposals for one-time expenditures to pay off recurring debt totaling \$23.0 million are classified as present law adjustments:
 - Paying off the IRIS debt
 - Full payment of the Crow Tribe settlement

**LFD
ISSUE**

Present law is defined in statute as "...that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:

- 1) changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;
- 2) changes in funding requirements resulting from constitutional or statutory schedules or formulas;
- 3) inflationary or deflationary adjustments; or
- 4) elimination of nonrecurring appropriations."

Because present law is used to determine what it costs to maintain on-going operations of state government, it is an important indicator of whether service reductions are likely if that level of funding is not maintained. Therefore, it is important that present law accurately reflect true costs of maintenance of state government operations. While the purpose of the appropriations for debt and settlement payout may be an on-going expenditure of government and not a new function or initiative, the proposal to pay all of the costs in one biennium is a new policy initiative. As a consequence, the totals used to determine the on-going costs of government are skewed by the addition of these proposals.

EXECUTIVE NEW INITIATIVES (NEW PROPOSALS)

The Governor proposes over \$118 million in general fund new initiatives (new proposals) in the 2007 biennium. Of the total, over \$40 million is in HB 2 and the remainder is in other bills, language, or transfers. The Governor also proposes \$6.3 million in revenue initiatives that bring the net general fund impact to \$112.0 million over the biennium. The following figure shows the major initiatives, by source of appropriations authority and in order of magnitude.

Figure 12 Major New Initiatives - Executive Budget 2007 Biennium (Millions)	
Agency/Initiative	Amount
<u>Revenue Proposals</u>	
Department of Revenue Loan Payback*	(6.0)
Department of Justice Pathologist	(0.3)
Total Revenue Proposals (revenue increase)	<u>(6.3)</u>
<u>Expenditure Proposals</u>	
Increased repair/maintenance (long-range building)	\$30.0
State employee pay plan	31.6
Protested property tax reserve	4.0
Replace cultural trust fund balance	3.9
Pay federal government for share of workers' compensation transfer to general fund	0.2
Pension funds actuarial soundness	7.2
Other Language Appropriations	1.4
Total Non-HB 2 Expenditure New Proposals	\$78.3
<u>HB 2</u>	
Various - Enhance/Complete Computer Systems**	\$9.9
OPI - Various Education Programs	5.5
University System - 2 Year Education Units Equipment	5.0
University System - Shared Leadership	4.9
Administration - Emergency Telecommunications	4.1
DPHHS - Add Waiver Clients/Reduce Wait List/Meals on Wheels/Psych Access	2.2
Judiciary - "Unfit to Proceed" Costs	2.0
DPHHS - Nursing Home Bed Tax	1.9
DPHHS - CHIP Enrollment Increase	1.7
Labor and Industry - Employment Security Account Funding Switches***	1.2
DPHHS - Child Support Maintenance	0.8
DPHHS - Continuance of Diversion of Tobacco Tax	0.7
Administration - Public Safety Communications	0.6
OPI - Indian Education for All	0.5
Other Agencies, Net of Miscellaneous Reductions****	-1.0
Total HB 2 New Proposals	<u>\$40.0</u>
Total Expenditure New Proposals	<u>\$118.3</u>
Total New Proposals	<u>\$112.0</u>
*Savings as a result of \$16 million IRIS debt payoff	
**Includes only those enhancement requested in new proposals. As such, it excludes completion of POINTS, and the gambling control enhancement.	
***Reversal of fund switch enacted by the 2003 Legislature	
****Various costs savings in DPHHS total \$3.1 million. The Department of Justice statewide FTE reduction (\$0.46 million) is included in new proposals.	

Figure 13 shows the expenditure proposals, only, by functional area of government. As evidenced by the spending allocations, Governor Martz priorities are to:

- Provide a pay plan for state employees (page 80 of this volume)
- Provide maintenance on state buildings (Section F in Volume 4)

- Enhance, complete, or develop various computer systems for ongoing operations of several agencies (various agencies, Volumes 3 and 4)
- Provide enhanced funding to school districts for specific programs (beginning on page E-1 of Volume 4)
- Promote economic development in partnership with the Montana University System (beginning on page E-75 of Volume 4)
- Provide for emergency and public safety communications (beginning on page A-174 of Volume 3)
- Enhance services to clients of various human services programs and increase rates to certain providers (beginning on page B-1 of Volume 3)
- Maintain the actuarial soundness of the various pension plans (page 88 of this volume)

Figure 13 Expenditure New Initiatives by Functional Area - Executive Budget 2007 Biennium (Millions)			
Agency/Initiative	Amount	Percent of Total	Cumulative Percent
<u>Various Agencies/Not Agency Related</u>			
Executive Pay Plan	\$31.6	26.7%	
Increased Repair/Maintenance - Long Range Building	30.0	25.4%	
Enhance/Complete Computer Systems*	9.9	8.4%	
Pension Funds	7.2	6.1%	
Language Appropriations	1.4	1.2%	
Pay Federal Government for Workers' Comp	0.2	0.2%	
Subtotal Various Agencies	\$80.3	67.9%	67.9%
<u>Higher Education</u>			
2 Year Education Units Equipment	\$5.0		
Shared Leadership	4.9		
Subtotal Higher Education	\$9.9	8.4%	76.2%
<u>Human Services (DPHHS)</u>			
Add Waiver Clients/Reduce Wait List/Meals on Wheels/Psych Access	\$2.2		
Nursing Home Bed Tax	1.9		
CHIP Enrollment Increase	1.7		
Child Support Maintenance	0.8		
Continuance of Diversion of Tobacco Tax	0.7		
Miscellaneous Other (Including Cost Savings)	-2.2		
Subtotal	\$5.2	4.4%	80.6%
<u>K-12 Education</u>			
Various Education Programs	\$5.5		
Indian Education for All	0.5		
Audiology	0.2		
Subtotal K-12 Education	\$6.1	5.2%	85.8%
<u>All Other Agencies</u>			
Administration - Emergency Telecommunications	\$4.1		
Administration - Public Safety Communications	0.6		
Arts Council - Replace Cultural Trust	3.9		
Revenue - Protested Property Tax Reserve	4.0		
Judiciary - "Unfit to Proceed" Costs	2.0		
Labor and Industry - Employment Security Account Funding Switches**	1.2		
Miscellaneous Other (Including Justice Statewide FTE Reduction)	1.0		
Subtotal All Other Agencies	\$16.8	14.2%	100.0%
Total All Initiatives*	<u>\$118.3</u>		
*The only Department of Corrections new proposal was for computer enhancement, included in the "Enhance/Complete Computer Systems" item.			

The figure shows that the proposed pay plan and increased maintenance on state properties would be over half of the proposed new initiatives. If computer systems, human services and education increases were added, the total would increase to almost 80 percent.

A major new initiative not included on this list because the Governor classifies it as a present law adjustment is the proposal to payout all debt and settlement obligations for the integrated revenue information system (IRIS) and the Crow Tribe settlement, totaling \$23 million. It is the payoff of IRIS debt (\$16 million) that enables the \$6 million loan payback revenue enhancement, as early payoff of the debt eliminates the general fund obligation for debt service payments in the 2007 biennium.

FIXED COSTS

Several programs within state government provide services to other functions of state government, for which they charge a fee. The legislature budgets funds so that the agencies receiving services can meet the costs of those services. The legislature does not appropriate funds for the provider programs because they are utilizing internal service funds, which do not require appropriations.

In those cases, the legislature approves the rates charged by provider programs.

Figure 14 details each of the internal service programs and the total fixed costs included in the executive budget in support of funding those functions. The figure also compares total costs in the executive budget in the 2007 biennium with costs budgeted in the 2005 biennium.

Figure 14 Comparison of Fixed Costs 2005 to 2007 Biennium (in Millions)					
Subcommittee/Agency	Program	2005 Biennium	2007 Biennium	Difference	Percent
General Government					
Administration	Insurance and Bonds	\$30.223	\$28.932	(\$1.291)	-4.3%
	Warrant Writing Fees	1.733	1.584	(0.149)	-8.6%
	Payroll Service Fees	0.897	0.906	0.009	1.0%
	Data Network Services	19.455	21.585	2.130	10.9%
	SABHRS Operating	9.446	12.670	3.224	34.1%
	Messenger Services	0.268	0.324	0.056	21.0%
	Rent - Buildings	11.506	13.523	2.017	17.5%
	Audit Fees	2.799	3.074	0.275	9.8%
Legislative Audit Division					
Natural Resources and Commerce					
Fish, Wildlife, and Parks	Grounds Maintenance	0.638	0.669	0.031	4.9%
Various	Statewide Cost Allocation/State Fund Allocation	<u>2.209</u>	<u>3.673</u>	<u>1.464</u>	66.3%
Total		<u>\$79.174</u>	<u>\$86.942</u>	<u>\$7.768</u>	9.8%

As shown, fixed costs increase by over \$7.7 million in the 2007 biennium over the 2005 biennium appropriations. Costs for most charges show significant increases, with the allocation reduced in two functional areas. The following briefly discusses each area of significant increase.

- **SABHRS Operating** – SABHRS operating allocates the costs of the centralized Statewide Accounting, Budgeting, and Human Resources System to state agency budgets. During the 2005 biennium, SABHRS was billed based on a service level agreement outside of the allocation model comprised of most other computer applications. For the 2007 biennium, SABHRS was included in the cost allocation model. Inclusion of SABHRS in the cost allocation model shifted costs from other system applications to SABHRS. It is this methodology change that causes the SABHRS costs to increase.
- **Messenger Services** – Messenger services include all mail sorting, pickup, and delivery to state agencies. Cost increases are primarily because the legislature lowered these charges in the 2005 biennium to deplete a large fund balance. Costs in the 2007 biennium are comparable to the 2003 biennium.

- Rent – Rent consists of a per square foot charge to agencies for occupied office and warehouse space. Office space per square footage rental rates increase 10.4 percent in FY 2006 over the FY 2004 level and an additional 1.0 percent FY 2006. Warehouse rates increase about 73.0 percent. Increases are due to increases in utilities, maintenance, and contracted services (such as janitorial), as well as a change in the allocation of costs for warehouse space to include a greater number of facility costs.
- Statewide Cost Allocation/State Fund Cost Allocation – The Statewide Cost Allocation Plan (SWCAP) is combined by the executive in the 2007 biennium with the State Fund Cost Allocation Plan (SFCAP). SWCAP, which was not previously allocated as a fixed cost to agencies, is an indirect charge to ensure that non-general fund sources help support a variety of general fund functions that support all of state government. These funds are deposited to the general fund. SFCAP is a direct charge against non-general fund state sources to ensure that those sources also support centralized functions of state government. The increase is primarily due to addition of a fixed cost allocation for SWCAP to ensure appropriate payment by agencies.

Each of the fixed costs and related issues enumerated above are discussed in greater detail in the Department of Administration narrative in Volume 3, and in the Department of Fish, Wildlife, and Parks (capitol grounds maintenance) in Volume 4 of the Legislative Budget Analysis 2007 Biennium.

INFLATION/DEFLATION

Statute requires the governor to submit a present law budget, with “present law” defined as “that additional level of funding needed to maintain operations and services at the level authorized by the previous legislature”. The statutory definition includes inflationary and deflationary adjustments. The executive budget does not include a general inflation factor for all operating expenses, but instead applies an inflation or deflation factor to fiscal 2004 expenditures for only 10 specific items.

Figure 15 shows the executive budget inflation and deflation factors and the items to which they are applied. Of the 10 items, the 3 inflated items are purchased outside of state government. The deflated items or services are purchased from other state agencies, and payments for these items or services go into a proprietary account. The legislature sets the rates that other state agencies must pay for the items or services, and thus determines the fund levels maintained in proprietary accounts.

Although the executive is requesting inflationary increases for electricity and natural gas appropriations, it is also requesting that the legislature approve a Governor’s Office language appropriation in HB 2 for \$1.7 million general fund and \$2.0 million state special and federal special funds. These amounts would become appropriated if the state’s natural gas contract and electricity default supplier rates for the 2007 biennium exceed the rates paid in fiscal 2004 as inflated by the percentages listed in Figure 15. Please see the LFD comment in the Office of Budget and Program Planning narrative under the Governor’s Office (Volume 3, Legislative Budget Analysis, 2007 Biennium, page A-64) for further details.

Figure 15 Inflation and Deflation Factors Executive Budget 2007 Biennium									
Account	Item Name	Percentage Change From Fiscal 2004 Base		Dollar Change					
		Fiscal 2006	Fiscal 2007	State Agencies		University System		Total	
		Fiscal 2006	Fiscal 2007	Fiscal 2006	Fiscal 2007	Fiscal 2006	Fiscal 2007	Fiscal 2006	Fiscal 2007
<u>Inflation</u>									
62601	Electricity	1.00%	2.00%	\$46,851	\$93,703	\$46,195	\$92,391	\$93,047	\$186,094
62603	Natural Gas	18.00%	12.00%	400,239	266,826	482,970	321,980	883,209	588,806
63125	Library Books	6.00%	9.00%	<u>21,439</u>	<u>32,158</u>	<u>220,055</u>	<u>330,083</u>	<u>241,494</u>	<u>362,241</u>
	Subtotal			\$468,530	\$392,687	\$749,221	\$744,454	\$1,217,750	\$1,137,141
<u>Deflation</u>									
62142	Disk Storage Charges DofA	-10.00%	-10.00%	(\$102,873)	(\$102,873)	\$0	\$0	(\$102,873)	(\$102,873)
62172	Batch CPU Seconds DofA	-10.00%	-10.00%	(111,996)	(111,996)	(133)	(133)	(112,128)	(112,128)
62177	TSO CPU Seconds DofA	-10.00%	-10.00%	(22,964)	(22,964)	0	0	(22,964)	(22,964)
62178	IDMS CPU Seconds DofA	-10.00%	-10.00%	(214,067)	(214,067)	0	0	(214,067)	(214,067)
62180	CICS CPU Seconds DofA	-10.00%	-10.00%	(22,696)	(22,696)	0	0	(22,696)	(22,696)
62404	In-State State Motor Pool	-13.00%	-12.50%	(282,441)	(271,578)	(3,396)	(3,266)	(285,837)	(274,843)
62510	Motor Pool-Lease Vehilces	-13.00%	-12.50%	<u>(329,142)</u>	<u>(316,483)</u>	<u>0</u>	<u>0</u>	<u>(329,142)</u>	<u>(316,483)</u>
	Subtotal			(\$1,086,178)	(\$1,062,655)	(\$3,529)	(\$3,398)	(\$1,089,707)	(\$1,066,054)
	Net Change			<u>(\$617,648)</u>	<u>(\$669,968)</u>	<u>\$745,692</u>	<u>\$741,055</u>	<u>\$128,044</u>	<u>\$71,088</u>

LONG RANGE PLANNING

The Governor's request for Long-Range Planning (LRP) includes a total of \$197.2 million for grants, loans, capital projects, and environmental cleanup. The executive request is summarized in Figure 16.

The most significant funding request for LRP includes a total of \$161.2 million for projects included in the Long-Range Building Program (LRBP). The request is an increase of 102 percent from the projects approved in the 2005 session. In addition, a \$5.1 million bond issue is recommended for the construction of Montana Department of Transportation (DOT) equipment storage buildings statewide. The debt service on the proposed issue will be paid with DOT state special revenue. Consequently, no new general fund debt service payments will be incurred during the 2005 biennium through this program.

The executive budget includes two uses of "one-time" monies from the general fund for Long Range Planning programs. The first recommendation is a \$30 million transfer to the LRBP account. The funds will to be used to make headway on the severe backlog of deferred maintenance in the state complex. The second transfer is \$3.9 million, and would replenish the Cultural Trust corpus for the state purchase of Virginia and Nevada Cities in 1997. Both general fund transfers are designed to save state funds in the future.

In funding a one-time-only additional \$30 million for LRBP projects, the executive addresses the need for deferred maintenance in state complex and provides potential cost savings for future biennia. Savings will occur because the future cost of projects will increase both as the buildings fall into greater disrepair and as the cost of materials and labor increase over time. While the backlog of deferred maintenance will remain critical, at an estimated cost of over \$100 million, the additional funds will slow the buildup of necessary deferred maintenance projects during the 2007 biennium. Consequently, the state will experience savings by funding the deferred maintenance now.

Figure 16 Executive Budget Request Long-Range Planning 2007 Biennium		
Program / Project	Amount	Program Total
Long-Range Building Program		\$161,203,540
Projects Funded with Cash/Current Revenues	\$156,103,540	
Projects Funded with Bonded Debt	5,100,000	
State Building Energy Conservation Program		2,500,000
Treasure State Endowment Program		17,400,000
Grants	17,400,000	
Loans	-	
Resource Indemnity Trust Grant & Loan Programs		15,257,876
Renewable Resource Grants	3,967,847	
Renewable Resource Loans	7,236,264	
Reclamation & Development Grants	4,053,765	
	8,021,612	
Cultural & Aesthetic Grant Program		800,553
Grants	770,553	
Capital Artwork Care & Conservation	30,000	
Total Long Range Planning Recommendations		<u>\$197,161,969</u>

General fund appropriations will no longer be required in future biennia for support of the Cultural and Aesthetic (C&A) grant program. Because the 1997 Legislature removed half of the trust corpus for the purchase of Virginia and Nevada Cities, the C&A grant program has required general fund dollars to bolster its ability to fund cultural grants. With the Governor's recommendation, the program will again be self-supporting.

LRP grant funding will be greater in the 2007 biennium as a result of higher interest earnings in several LRP programs. The Treasure State Endowment grant program (TSEP) and the Resource Indemnity Trust grant and loan programs (RIT) contain grant recommendations that exceed the grant awards of the 2005 biennium. The TSEP grant recommendation exceeds grants awarded in the 2005 biennium by 5.1 percent. Grants from the RIT grant and loan program will recommend grants at a level of 25.3 percent greater than were appropriated in the 2005 biennium.

Section F, in Volume 4, includes detailed information regarding each of the programs related to Long-Range Planning.



EXECUTIVE BUDGET – OTHER LFD ISSUES

INTRODUCTION

This section contains LFD issues related to the executive budget as a whole. These issues are in addition to specific issues raised in the agency budget presentations. Each item is listed here and discussed in further detail in the following pages.

HIGHLIGHTS

Unresolved Policy Issues. There are other issues with potential material impacts on the 2007 biennium budget for which the fiscal impacts are either uncertain or unknown, and are not addressed in the executive budget. Most notable is the K-12 funding lawsuit.

Structural Balance. Structural balance refers to the matching of ongoing expenditures of government with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. The executive budget appears to be structurally balanced. However, the amount by which ongoing revenues exceed ongoing expenditures might be argued.

Expenditure Limitation. Section 17-8-106, MCA, provides for an expenditure limitation intended to control growth in state government spending. The executive budget exceeds the statutory limit for growth in the budget, meaning that the growth in the budget exceeds average Montana personal income growth.

Governor Martz Budget Revisions. The executive submitted minor amendments to the original executive budget on December 15, with a total general fund impact of \$1.9 million. Although not included in the LFD analysis, the items will be brought to the attention of the applicable appropriations subcommittee.

UNRESOLVED POLICY ISSUES

There are other issues with potential material impacts on the 2007 biennium budget for which the fiscal impacts are either uncertain or unknown, and are not addressed in the executive budget. Most notable is the K-12 funding lawsuit, discussed on page 119 of this volume. Other pending litigation issues are discussed on page 124 of this volume.

Six issues with potential major fiscal impacts that either currently cannot be estimated or are of unknown resolution are discussed in this section. The executive budget does not specifically address the issues due to their uncertainty, but the legislature should be aware that significant resources and/or policy changes could be required and these issues should be considered in legislative deliberations to balance the budget.

MEDICARE MODERNIZATION ACT

The federal Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) was signed into law in December 2003. The most significant change due to passage of the MMA is the addition of an outpatient prescription drug benefit (Part D) for Medicare beneficiaries, which is one of the most fundamental changes to Medicare in recent history. Despite state and federal implementation issues, outpatient drug assistance is a significant benefit for Medicare beneficiaries. To date, there are many undefined aspects of the MMA, including the underlying data needed to calculate the fiscal effects. At this point, it is not possible to tell whether Montana will experience a net gain or loss in general fund costs due to offsetting aspects of the MMA, and it is not evident how fiscal and policy issues associated with the MMA will be addressed in the executive legislative package. For a further discussion, see page 140 of this volume and page B-16 in Volume 3.

MAIDS LAWSUIT

In September 2002, the Montana Association for Independent Disability Services, Inc. (MAIDS) and several individuals with developmental disabilities filed suit. This suit alleges that the disparity in wages and benefits paid to employees of community based providers verses the wages and benefits paid to employees of state institutions has resulted in irreparable and unnecessary harm to the plaintiffs.

A finding in favor of the plaintiffs and requiring the state to reimburse contractors at a level that provides direct care wage rates that are comparable to state employees would likely have a financial impact on the developmental disabilities system that would be measured in terms of millions of dollars. The potential for similarly situated employee groups of contractors to file similar legal actions exists. The probability and magnitude of such action is currently unknown. Furthermore, how such a finding might impact the definition of employee/employer relationships and other aspects of labor relations and compensation has not been studied.

For a further discussion, see page B-31 of Volume 3.

FIRE COSTS

The state's share of fire suppression costs is funded with general fund. Traditionally, the legislature does not budget for fire costs due in part to the uncertainty of what those costs will be. Instead, the legislature provides a supplemental appropriation in the next legislative session to pay all state costs. The primary issues with this approach are whether the fund balance will be adequate to pay all costs, as well as whether the state has sufficient cash flow to pay all costs due until the legislature can act.

The state experienced a severe fire season in FY 2004. The costs of that fire season would normally have placed a severe strain on state resources that would likely have necessitated a special session to provide authority to pay immediately due bills and/or reduce other expenditures to pay fire costs. However, a one-time general-purpose grant from the federal government was used for all state costs. It is highly unlikely that this largesse from the federal government will be repeated. Given the continuing drought, the 2007 biennium fire seasons could also be severe, and absent some other mechanism, the ending fund balance would need to be sufficient to address those potential costs. For a further discussion, see page C-129 in Volume 4.

PUBLIC DEFENDER

The Law and Justice Interim Committee voted to introduce legislation in the 2005 legislative session to provide a statewide public defender system, which could have a significant fiscal impact on the Judiciary. The system proposed would provide public defender services in criminal and certain civil cases for any individual who is: 1) determined to be financially unable to retain private counsel; and 2) accused of an offense that could result in the person's loss of life or liberty if the person is convicted. The proposed system would provide public defender services in the Supreme Court or in any district court, justice court, or city or municipal court in the state. The cities and counties would continue to contribute funding in recognition of the incorporation of non-state courts.

District court assumption has proved to be significantly more costly than originally envisioned, in large measure due to higher than anticipated public defender costs. Increases in the number or severity of cases could have a significant impact on costs. In addition, the mechanisms in place to determine appropriate costs of services, and to ensure that the state is not subsidizing the local courts, will also be critical in future cost determinations.

For a further discussion, see page A-29 in Volume 3.

SB 424 – IMPACT AID ISSUE

Beginning in FY 2005, SB 424 requires school districts to pay employee retirement costs out of the fund from which the employees' wages are funded. In September 2003, a coalition of impact aid school districts petitioned the US Department of Education for a hearing regarding whether SB 424 violated federal law. The federal law in question says that a state may not make less state aid available to school districts as a result of the district's impact aid status. The Department of Education held a hearing in Helena in March 2004, and ruled against the state in June. The plaintiffs filed a petition in June 2004 for declaratory judgment and injunctive relief and also sought a preliminary injunction to halt implementation of SB 424. The case was dismissed in district court. Subsequently, the plaintiffs appealed to the Supreme Court, which granted the preliminary injunction in August 2004, but then reversed itself in September 2004. The case remains in the Supreme Court and it may rule on the case in 2005.

Should the state lose this case the cost to the general fund in guaranteed tax base aid for retirement costs will be approximately \$1.0 million per year.

NATIONAL ANTI-TERRORISM BILL

The national anti-terrorism bill was signed into law on December 17, 2004. A component of this law is the requirement that each state have similar drivers' licenses to make it harder to produce and obtain fake licenses. The Montana Department of Motor Vehicles (DMV) believes that Montana's drivers license already meets the basic requirements of this standard license, but that some changes may need to be made to Montana's birth certificates, which are used as a primary document to prove identity by the state. DMV does not have an analysis of the costs associated with any changes required pending rule creation and promulgation by the federal government.

STRUCTURAL BALANCE

GENERAL FUND

Structural balance refers to the balancing of ongoing expenditures with ongoing revenues. If revenues equal or exceed expenditures, then structural balance is achieved. If expenditures exceed revenues, then structural *imbalance* occurs. General fund expenditures exceeded ongoing revenues for 12 of the past 22 years (see Figure 1). In the mid- to late-1990's, the legislature made significant progress, reaching a sizable positive balance in FY 2000. It should be noted that during this time, Montana as well as other states were reaping the benefits of an information technology boom and the significant increase in capital gains tax collections. However, the pendulum shifted the other way beginning in FY 2001, where revenues were slightly above expenditures. The unprecedented revenue shortfall in the 2003 biennium intensified the imbalance heading into the 2005 biennium. Historically, legislators have faced the ever-present difficulty of holding down budget growth when confronted with double-digit growth in corrections costs, increased human services demands, and pressures for increased education funding. In the 2005 session, legislators will enjoy what appears to be a structurally balanced executive spending proposal, although there is some question as to whether some of the projected revenues are truly ongoing.

Figure 1

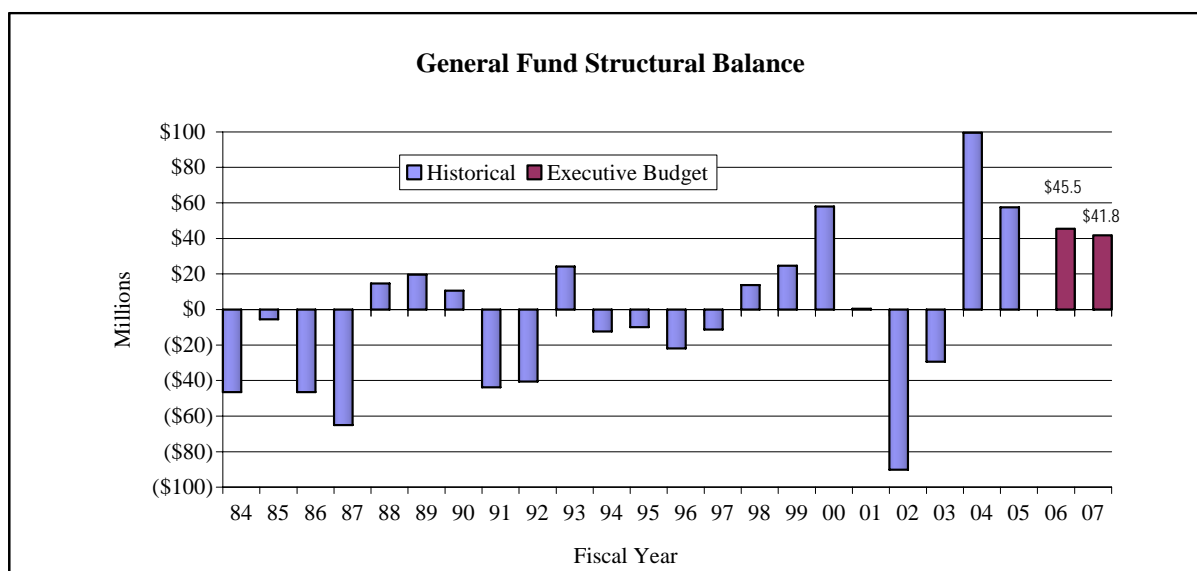


Figure 2 shows that the anticipated revenues, using revenue estimates in HJR 2, exceed ongoing expenditures proposed in the executive budget for the 2007 biennium by \$87.3 million. However, one might argue that a portion of oil and gas taxes should not be considered ongoing revenue, as this revenue source is likely to go through a period of correction that will result in a lower level of ongoing revenues. Inclusion of one-time sources of revenue results in a misleading estimation of structural balance. Since the executive budget uses the total revenue estimate in its determination of structural balance, it may be necessary to make some adjustments. The following narrative establishes the adjustment necessary for one-time revenues and expenditures to arrive at a comparison of ongoing revenues to ongoing expenditures.

Figure 2

Revenue and Disbursement History General Fund & School Equalization Accounts In Millions										
Fiscal Year	General Fund		Surplus /	School Equalization		Surplus /	GF/SEA	GF/SEA	Surplus /	Biennium
	Revenue	Disburse.	Deficit	Revenue	Disburse.	Deficit	Revenue	Disburse.	Deficit	Surplus/Deficit
A 84	\$330.305	\$357.387	(\$27.082)	\$242.384	\$261.753	(\$19.369)	\$572.689	\$619.140	(\$46.451)	
A 85	364.522	380.359	(15.837)	281.275	271.016	10.259	645.797	651.375	(5.578)	(\$52.029)
A 86	349.541	366.815	(17.274)	252.899	282.166	(29.267)	602.440	648.981	(46.541)	
A 87	346.690	391.325	(44.635)	263.052	283.428	(20.376)	609.742	674.753	(65.011)	(111.552)
A 88	391.152	370.853	20.299	276.216 *	281.886	(5.670)	667.368	652.739	14.629	
A 89	411.729	388.270	23.459	275.589 *	279.536	(3.947)	687.318	667.806	19.512	34.141
A 90	447.962	432.323	15.639	282.389	287.393	(5.004)	730.351	719.716	10.635	
A 91	420.257	457.612	(37.355)	385.031	391.500	(6.469)	805.288	849.112	(43.824)	(33.189)
A 92	487.036	523.072	(36.036)	393.591 *	398.059	(4.468)	880.627	921.131	(40.504)	
A 93	539.955	523.553	16.402	412.903	405.067	7.836	952.858	928.620	24.238	(16.265)
A 94	480.021	497.921	(17.900)	411.834	406.388	5.446	891.855	904.309	(12.454)	
A 95	646.149	535.461	110.688	289.199 *	409.822	(120.623)	935.348	945.283	(9.935)	(22.389)
A 96	963.193	984.997	(21.804)				963.193	984.997	(21.804)	
A 97	986.570	997.835	(11.265)				986.570	997.835	(11.265)	(33.069)
A 98	1,034.382	1,020.591	13.791				1,034.382	1,020.591	13.791	
A 99	1,068.111	1,043.418	24.693				1,068.111	1,043.418	24.693	38.484
A 00	1,163.641	1,105.598	58.043				1,163.641	1,105.598	58.043	
A 01	1,269.472	1,268.938	0.534				1,269.472	1,268.938	0.534	58.577
A 02	1,265.713	1,355.903	(90.190)				1,265.713	1,355.903	(90.190)	
A 03	1,246.381	1,275.827	(29.446)				1,246.381	1,275.827	(29.446)	(119.636)
A 04	1,381.565	1,282.038	99.527				1,381.565	1,282.038	99.527	
F 05	1,384.639	1,327.162	57.477				1,384.639	1,327.162	57.477	37.368
F 06	1,432.075	1,386.600	45.475	Executive Budget **			1,432.075	1,386.600	45.475	
F 07	1,472.515	1,430.690	41.825	Executive Budget **			1,472.515	1,430.690	41.825	87.300

* Excludes Education Trust & General Fund Transfers.
 ** Excludes Executive One-Time Proposals
 Note: The 1995 Legislature de-earmarked school equalization revenue to the general fund.

One-time revenues

The prices for oil and gas reached record levels in the past several months and have since declined. It is not known where the prices might level off, but it is expected to be at a level well below the record highs. For purposes of determining structural balance, an assessment of where oil and gas prices will level off is key. This is discussed in the section titled "Long-Term Stability of General Fund" on page 142 of this volume. If it is assumed that the amount of \$80 million of oil revenues is not ongoing revenue, then the positive structural balance of the executive budget is substantially reduced (see Figure 3) below. Although this is probably a worst-case scenario, it demonstrates the concern regarding the stability or instability of the general fund.

One-time expenditures

The executive budget balance sheet designates certain expenditures as one-time. Therefore, there is no need to adjust the projected structural balance estimate for one-time expenditures. It is possible, however, that the legislature may budget for some services on a one-time only basis. If this occurs, such expenditures can be used to offset the negative implications of one-time revenue.

Expenditure proposals

There are three other ways in which structural balance can be adversely impacted in subsequent biennia, on the expenditure side:

- Expanded expenditure growth, such as is represented in the proposed budget (approximately 10 percent biennial growth), can adversely impact structural balance. The school funding issue may result in even further expansion of expenditures.
- Realization of delayed implementation of expenditures. Annualization of the 2007 biennium pay plan, as proposed by the executive, will require an additional \$48.8 million general fund in the 2009 biennium.
- Growth in services rising from expansions in such programs as Medicaid or from increases in prisoner populations supervised by the Department of Corrections. For any increase in annual expenditures, there must be ongoing revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth.

Achieving structural balance is a significant policy issue that the Fifty-ninth Legislature will need to address. If successful, in the 2007 biennium the legislature will make the budget process less problematic for both the executive and legislative branches in subsequent biennia.

LFD ISSUE

Based on the submitted balance sheet, the executive budget proposal for the 2007 biennium shows revenues are \$50.3 million greater than disbursements. The executive calculation does not consider any portion of the estimated revenues as being one-time. Figure 3 shows the structural balance for the 2007 biennium, comparing executive and legislative numbers. The structural balance in fiscal 2007 is \$50.3 million using executive numbers, and \$87.3 million using Revenue and Transportation Interim Committee estimates. The third column removes a portion of oil revenues to demonstrate the notion that oil revenues may return to earlier trends and should arguably not be considered ongoing revenues. Even then, the executive budget is structurally balanced.

Figure 3

Structural Balance 2007 Biennium (Millions)			
Item	Executive Budget	Using RTIC Estimate	Removes Portion of Oil Revenues
Anticipated Revenue	\$2,867.6	\$2,904.6	\$2,904.6
One-Time Revenue	0.0	0.0	(80.0)
Ongoing Revenue	2,867.6	2,904.6	2,824.6
Ongoing Expenditures	2,817.3	2,817.3	2,817.3
Structural Balance	\$50.3	\$87.3	\$7.3

OTHER FUNDS

In addition to issues of structural balance in the general fund, there are issues of structural balance in some of the state special revenue accounts included in the executive budget. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. One example is the highway special revenue account, which funds highway construction and maintenance and safety related costs. This fund is in a chronic state of structural imbalance due to an inelastic revenue source and inflationary construction costs. In other parts of the executive budget, the legislature will find instances in which the executive has proposed expenditures that exceed revenue. By budgeting from these accounts at expenditure levels that exceed ongoing revenues, the executive draws down the fund balance and creates program expenditure levels that cannot be sustained. Therefore, future legislatures would be faced with reducing program expenditure levels or increasing revenue. In agency sections of the Legislative Budget Analysis, staff has identified those instances in which expenditures from an account exceed anticipated ongoing revenues.

EXPENDITURE LIMITATION

2007 BIENNIUM EXECUTIVE BUDGET EXCEEDS STATUTORY LIMIT

Section 17-8-106, MCA, limits the increase in biennial appropriations ("state expenditures") from the general fund, state special revenues, and the cash portion of the capital projects fund to the growth in Montana's personal income. With two exceptions, appropriations for the 2007 biennium cannot exceed appropriations for the 2005 biennium increased by the growth in Montana personal income. Section 17-8-106, MCA, states:

Expenditure limitation -- exception. (1) Except as provided in subsection (2), the state expenditures for a biennium may not exceed the state expenditures for the preceding biennium plus the product of the state expenditures for the preceding biennium and the growth percentage. The growth percentage is the percentage difference between the average Montana total personal income for the 3 calendar years immediately preceding the next biennium and the average Montana total personal income for the 3 calendar years immediately preceding the current biennium.

(2) The legislature may appropriate funds in excess of this limit from the reserve account if:

(a) the governor declares that an emergency exists; and

(b) two-thirds of the members of each house approve a bill stating the amount to be spent in excess of the expenditures limitation established in subsection (1), the source of the excess revenue to be spent, and an intention to exceed the limitation.

(3) Expenditures may exceed the expenditures limitation only for the year or years for which an emergency has been declared.

(4) The legislature is not required to appropriate the full amount allowed in any year under subsection (1).

The proposed executive budget for the 2007 biennium exceeds the statutory expenditure limit by \$12.6 million. Under the executive recommendation, the increase in spending in applicable categories that are affected by the limitation will be greater than the growth in Montana's personal income between 2000-2002 and 2002-2004.

The following is a summary of the expenditure limitation calculations applied to the executive budget for the 2007 biennium.

CALCULATION OF LIMIT

The following types of appropriations are excluded from the calculations:

- Money received from the federal government
- Payments on bonded indebtedness
- Money paid for unemployment or disability benefits
- Money received from the sale of goods and services
- Money paid from permanent endowments, constitutional trusts, or pension funds
- Proceeds from gifts and bequests
- Money appropriated for tax relief
- Funds transferred within state government or used to purchase goods for resale

Four steps are required to determine the expenditure limit:

Step 1 - Determine the base appropriation level for the 2005 biennium

Step 2 - Determine the executive request for the 2007 biennium by summing appropriations for the general fund, state special revenue, and the cash portion of the capital projects fund. Exclude any of the items listed above.

Step 3 - Determine the growth in average personal income for the three years preceding the current biennium (2000, 2001, and 2002) and the three years preceding the next biennium (2002, 2003, and 2004). The growth in Montana's personal income between these two periods is 8.53 percent.

Step 4 - Increase the 2005 biennium base appropriations by the growth in personal income to establish the expenditure limitation. Subtract the executive budget appropriations for the 2007 biennium from the 2005 base limitation. This difference is a negative \$12.6 million.

Compliance

Figure 4 shows the calculations used to determine the spending limitation for the 2007 biennium. The calculations show that the executive budget recommendations for the 2007 biennium exceed the expenditure limit by \$12.6 million. To comply with statute in setting the 2007 biennium budget, the legislature has the following options:

- Reduce total requested appropriations from the general fund, state special revenue fund, and/or the cash long-range building program by \$12.6 million below the executive level.
- As allowed in 17-8-106(2), MCA, if legislation is passed by 2/3 of the members of each house, the limit may be exceeded. The legislation must: 1) state the amount of excess to be spent; 2) the source of the excess revenue to be spent; and 3) an intention to exceed the limitation.
- Repeal 17-8-106, MCA, effective FY 2005

LFD ISSUE

The proposed executive budget for the 2007 biennium exceeds the statutory expenditure limit by \$12.6 million. Regardless of the executive budget proposal, if the legislature increases school funding above the amounts in the executive budget without any corresponding reductions in other areas and/or utilizes more of the one-time revenue to fund one-time expenditures, the expenditure limit will be exceeded. This will require the 59th Legislature to choose from the options listed above.

Figure 4
Expenditure Limitation Calculation
2007 Biennium

<u>Step 1</u>	<u>Fiscal 2004</u>	<u>Fiscal 2005</u>	<u>Biennium</u>
Base Appropriations			
State Expenditures*	\$2,108,265,004	\$1,934,720,981	\$4,042,985,984
Exclusions			
Debt service	(19,754,000)	(19,430,000)	(39,184,000)
Unemployment benefits	(582,718)	(582,718)	(1,165,436)
Proceeds of gifts or bequests**	0	0	0
Tax relief	0	0	0
Transfers	0	0	0
Total Exclusions	(\$20,336,718)	(\$20,012,718)	(\$40,349,436)
Base Appropriations	<u>\$2,087,928,286</u>	<u>\$1,914,708,263</u>	<u>\$4,002,636,548</u>
<u>Step 2</u>	<u>Fiscal 2006</u>	<u>Fiscal 2007</u>	<u>Biennium</u>
Executive Budget			
State Expenditures*	\$2,287,660,463	\$2,107,127,357	\$4,394,787,820
Exclusions			
Debt service	(18,394,667)	(18,523,764)	(36,918,431)
Unemployment benefits	(522,975)	(522,975)	(1,045,950)
Proceeds of gifts or bequests**	0	0	0
Tax relief	0	0	0
Transfers	0	0	0
Total Exclusions	(\$18,917,642)	(\$19,046,739)	(\$37,964,381)
Executive Appropriations	<u>\$2,268,742,821</u>	<u>\$2,088,080,618</u>	<u>\$4,356,823,439</u>
<u>Step 3</u>	<u>Income</u>	<u>3-year Average</u>	<u>Growth %</u>
Personal Income Growth			
Calendar Year 2000	20,716,220,000		
Calendar Year 2001	22,281,006,000		
Calendar Year 2002	22,526,118,000	21,841,114,667	
Calendar Year 2003	23,651,446,000		
Calendar Year 2004 est.	24,937,723,000	23,705,095,667	8.53%
<u>Step 4</u>			
Expenditure Limitation			
Base Appropriations plus 8.53%		\$4,344,232,597	
Executive Budget		<u>4,356,823,439</u>	
Expenditure Balance		(\$12,590,841)	

* Appropriations of general fund, state special, cash capital projects

** The state accounting system does not track appropriations of donated revenue.

LFD ISSUE

The method differs with the method used to calculate budget comparisons required under 17-7-151, MCA, thus resulting in possible confusion by comparing different parts of the executive budget with different bases. The legislature may want to consider the value of the expenditure limitation and eliminate the requirement if it is found to be of little or no value.

GOVERNOR MARTZ BUDGET REVISIONS

Governor Martz submitted minor amendments to the original executive budget on December 15, with a total general fund impact of \$1.9 million. Due to timing, these amendments are not included in the LFD analysis, but are part of the official executive budget, and staff will bring them to the attention of the appropriations subcommittees as they act on agency budgets. Figure 5 summarizes the additions to the executive budget.

Figure 5
Governor Martz Budget Adjustments - December 15, 2004
2007 Biennium

Agency	General Fund		Other Funds		Comments
	FY 2006	FY 2007	FY 2006	FY 2007	
<u>HB 2</u>					
Governor's Office	---	---	(\$94,009)	(\$93,966)	Eliminate the Mental Health Ombudsman
DEQ*	2,000,000	---	---	---	Superfund related remedial studies
Corrections	---	---	-360,000	-360,000	Inmate Welfare Funds
Military Affairs	250,000	250,000			National Guard scholarship program
Public Health and Human Services	---	---	<u>3,339,016</u>	<u>4,032,460</u>	Adjust TANF caseload, benefits level
 Total HB 2	 \$2,250,000	 \$250,000	 \$2,885,007	 \$3,578,494	
<u>Statutory Appropriations</u>					
Adjust various statutory appropriations**	(\$1,200,000)				Reduce bond costs and certain payments
<u>Revenue Adjustments</u>					
Reduce institutional reimbursements	\$300,000	\$300,000	---	---	Reduce general fund revenue
<u>Other</u>					
Fish, Wildlife, and Parks	---	---	---	---	Change present law to new proposal
Public Health and Human Services	---	---	---	---	Change fund source in CHIP
Public Health and Human Services	---	---	---	---	Remove unnecessary TANF language
 Total 2007 Biennium Increased Costs (Reduced Revenue)	 <u>\$1,350,000</u>	 <u>\$550,000</u>	 <u>\$2,885,007</u>	 <u>\$3,578,494</u>	

*Biennial

**Over a three year period

Governor's Office - The executive budget funded the Mental Health Ombudsman, a position created by the legislature in response to consumer complaints during the establishment of mental health managed care, with federal Medicaid funds. According to the executive, the Centers for Medicare and Medicaid Services has determined the funds cannot be used for this purpose, and the executive proposes eliminating the Mental Health Ombudsman. The reduction includes 1.50 FTE.

Environmental Quality – This adjustment would add general fund for a superfund-related remedial investigation and feasibility study of three sites in the Kalispell area: 1) Kalispell Pole and Timber; 2) Reliance Refinery; and 3) Yale Oil Kalispell facilities.

Corrections – The executive included a HB 2 appropriation for a statutory appropriation, and withdraws the error.

Military Affairs – The executive funds the National Guard Scholarship program in the 2007 biennium. The program was funded for the 2005 biennium only at \$250,000 over the biennium.

Public Health and Human Services – The executive increases the temporary assistance for needy families (TANF) caseload estimate, and increases the monthly benefit by \$30.

Statutory Appropriations – The executive reduces statutory appropriation estimates for bond payments in FY 2005, and the cost of state contributions to local government law enforcement and fire personnel retirement costs for FY 2005, FY 2006, and FY 2007. Precise budget detail was not provided.

Revenue Reduction – The state institutions receive reimbursements from the federal government for Medicaid eligible residents. The executive has lowered the anticipated revenue to the general fund from these reimbursements.

Fish Wildlife and Parks – This change merely converts a present law adjustment to a new proposal for a decision package to restore non-game wildlife funds.

Public Health and Human Services – The first adjustment under “other” in Figure 5, changes the fund code for certain expenditures associated with specialty clinics. The second eliminates language no longer necessary.

